Q3 2022 Investor Letter | *November 15, 2022*

Dear Investor,

For the three months ended September 30, 2022, Bonsai Partners Fund, LP, appreciated 8.3% net of fees and expenses. The S&P 500 Total Return Index declined -4.9% 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	**-25.8%**	**-13.9%**	**277.9%**	**60.3%**	**-17.6%**	**218.9%**	**34.2%**
Bonsai Net Return	**-26.4%**	**-14.8%**	**247.9%**	**56.1%**	**-17.7%**	**180.2%**	**29.9%**
S&P 500 Return	-23.9%	28.7%	18.4%	31.5%	-8.6%	39.4%	8.8%

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.

To put it lightly, the current environment remains uncertain. With interest rates, inflation, and supply chains all quickly evolving, it is difficult to confidently make appraisals of what companies are worth. Eventually, these macroeconomic swings will stabilize, and this stability will offer a new set of guidelines for investors to make investment decisions. Until investors find their footing, volatility will likely remain the norm.

We will continue to underwrite investments with conservative assumptions and identify opportunities that we expect to perform well across a wide range of macroeconomic conditions. Our portfolio is increasingly gaining exposure to companies that will endure across various operating environments.

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While we had encouraging performance in the third quarter, I do not view this as a turning point for our portfolio or the economy. In October, for example, we continued to see volatility in our Chinese investments. We will continue to take advantage of volatility by hunting for new high-quality ideas. I remain long-term optimistic and near-term cautious.

Objectives for 2022

We will continue to progress against our existing goals for the remainder of the year. As a reminder, these are:

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

Our portfolio continues to improve, our operation is becoming more robust, and we are developing better systems to handle day-to-day tasks. These improvements should contribute to improved returns over the medium term.

I intend to share an updated set of objectives for 2023 in the fourth quarter letter, although I suspect some of these objectives may look the same.

New Investment: Wise Plc (LSE: WISE)

History of Cross-Border Money Transfers – The Problem

Moving money across borders is inefficient and expensive. Although we live in a hyper-connected internet age, global banks remain disconnected due to a lack of standardized global payment infrastructure. As a result of antiquated systems and processes, the average cross-border transfer loses 6% of its value to transaction fees.[1]

Most cross-border bank transfers move through "correspondent banking" relationships. In this system, banks form private agreements to become international correspondents, whereby they open accounts with one another in their local geographies. Rather than physically moving money across borders each time a customer requests an international transfer, corresponding banks debit and credit the other's account in local currency to balance out money sent or received. These are known as "Nostro" and "Vostro" accounts.

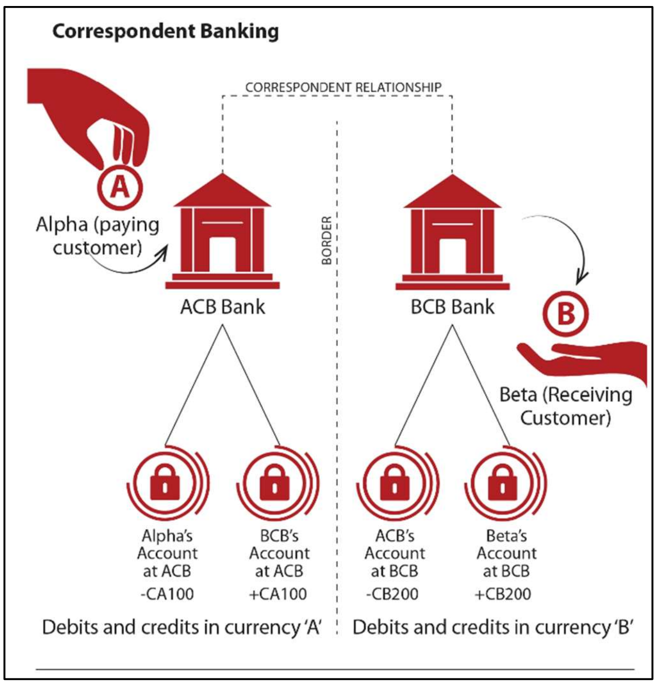


Image Credit: Benson, Carol. Global Payments: And the Fintech Innovations Changing the Industry. Glenbrook Press, 2020.

Since each bank cannot build and maintain correspondent relationships with every other bank in the world, banks rely on their correspondents' correspondent relationships to form a multi-layered network capable of reaching the ultimate destination of a transfer. This system resembles an airline that chooses to fly to certain destinations while relying on partner airlines for others. If a chain of four

[1] https://remittanceprices.worldbank.org/sites/default/files/rpw_main_report_and_annex_q222.pdf

corresponding banks is required to reach a destination bank, money moves to four different banks, and the transferer pays four layers of fees.

Correspondent banking began in the mid to late 1800s, and with the creation of SWIFT in the early 1970s, adoption rates of correspondent banking rapidly increased. While the limitations of correspondent banking are apparent in today's digital age, the system was a giant leap forward at the time.

SWIFT is a technology cooperative built and owned by a consortium of the world's largest banks. Their core technology is a messaging system that connects banks globally through a standardized protocol for sharing transaction details. These 'SWIFT messages' power the debits and credits within the correspondent transaction chain.

Since SWIFT is owned and controlled by banks, they have little ability or interest in improving their systems if it results in lower profitability for their constituents. As a result, SWIFT has only marginally improved over the years and represents a classic case of the "innovators dilemma." For SWIFT to enable more transparent, cheaper, and faster payments, it destroys profitability for its constituent banks.

Banks still enjoy the fruits of the correspondent system today because the high fees they agree to pay each other are passed along to their customers in a "quid pro quo."

To summarize, the correspondent banking system is:

1. **Expensive**: Costs are high because payments often travel through multiple correspondents who add layers of fees and currency conversion costs. These individual transfers lack economies of scale since each transaction is separate. Finally, the system's opacity allows banks to hide fees from their customers.

2. **Slow**: Cross-border payments take a long time to reach their end destination because each correspondent bank wants to hold these transferred funds as long as possible to earn interest on the balance. Duplicative sets of

operational processes occur at each step in the chain, slowing down the transaction. A global transfer can take multiple business days to clear.

3. **Not transparent**: Senders and recipients have little visibility into where money is in the process, how many transfer layers exist, or how fees are assessed.

Over the past ten to fifteen years, multiple fintech innovators emerged to challenge the correspondent system and the legacy high-cost money transfer companies (i.e., Western Union, Moneygram). These fintech challengers include Wise, Revolut, Remitly, Currencycloud, Thunes, Azimo, and others.

History of Wise – A Potential Solution to the Cross-Border Problem?

Wise (formerly known as TransferWise) was founded in 2011 by Kristo Käärmann and Taavet Hinrikus. The mission of Wise is to create "money without borders." To deliver on this lofty goal, the company needed to build a global payments infrastructure that was fast, convenient, transparent, and as close to free as possible.

Before founding Wise, Kristo worked abroad at Deloitte in London, earning his salary in British pounds, but stuck paying his mortgage back home in Estonia in euros. On the other hand, Kristo's friend Taavet worked for Skype while living in London, where he was paid in euros to his Estonian account but needed pounds for everyday London expenses.

The two realized they lost a significant amount of each paycheck to bank fees whenever they moved money between their own accounts in different countries. Taavet and Kristo formed an arrangement where Taavet would transfer euros into Kristo's Estonian bank account (from his European account), and Kristo would transfer an equivalent amount of pounds into Taavet's UK bank account (from his British account) using the mid-market foreign exchange rate. Since these transfers only relied on inexpensive domestic transfers, there were nearly no fees to execute these "cross-border" transactions. If you recall, this arrangement resembles the "Nostro" and "Vostro" accounts we described earlier for corresponding banks, but without the associated fees or delays. From this experience, Kristo and Taavet realized that their banks charged excessive fees and that a better system could theoretically move money globally for significantly less.

From this hypothesis, Wise built an alternative to the SWIFT-powered correspondent banking network. To do this, Wise built a network of their own bank accounts globally that directly handle the "Nostro/Vostro" accounts themselves rather than working through correspondents. By controlling its own network of global transmission points–using inexpensive domestic transfers for the “last mile”–Wise controls the fees and FX markups that its customers pay and removes unnecessary layers of middlemen.

Above: A Hypothetical Wise Transfer from the USA to Thailand

Due to Wise’s efficient infrastructure and a desire to offer their service at a low cost, the average Wise transaction costs ~0.60% of the value of the transaction, a dramatic cost savings for customers. In addition to lower costs, Wise’s infrastructure is significantly faster, with over 50% of transfers paid instantly to recipients and over 90% settled within 24 hours.

Wise’s speed, convenience, and cost propelled them to grow to over $100 billion USD[2] in annualized transfer volume, making them the largest non-bank cross-border transfer service worldwide, recently overtaking Western Union.

[2] As of FQ1 2023 annualized run-rate

How Wise Differs from Other Cross-Border Payment Companies

Wise is one of many companies building new infrastructure for cross-border money movement. While I cannot cover what every other fintech company is doing here, I can explain what specifically sets Wise apart.

I believe Wise's core differentiation is its **desire** and **ability** to deliver its services at the lowest prices to customers. By offering faster, cheaper, and more transparent transfers, more customers choose Wise.

In his book: *Bare Essentials*, Dieter Brandes explains how Aldi's low-price strategy propelled the supermarket chain to grow rapidly for decades:

> "If purchase prices drop, we lower our sale prices immediately, even if we [have not] bought at the new prices yet. We take the position: offensive action is better than defensive.
>
> It is far too easy to maintain a price even when the purchase price has fallen. But that would have an unpleasant, delayed impact, for the goal which must be achieved is that customers begin to believe that they cannot buy cheaper anywhere else. Once you have achieved that – and I believe that this is true for us – customers [won't] accept anything else. They will even rearrange their schedules to come at the best shopping times."

I believe Wise's track record of delivering the lowest prices and being transparent about the fees they charge **trained customers to believe they don't need to go anywhere else for their cross-border transfer needs.**

Wise earned an industry-leading Net Promoter Score of 71, with two-thirds of new Wise customers joining through word of mouth. In addition to users recommending Wise to others, recipients of funds often ask senders to join Wise because it can save them hundreds of dollars for a single transaction. The net result is that Wise only spent £28M in marketing to drive nearly £15 billion of incremental transfer volumes through their platform in FY2022.

Wise's ability and desire to deliver a better service at lower prices keep them ahead of their competition. Wise can offer the lowest prices to customers due to a unique set of advantages they've built. I outline these below:

1. **Wise's Culture & Mission: A Maniacal Focus on Lowering the Cost of Cross-Border Payments**

Although company culture is a squishy topic, lowering the cost of cross-border transfers is Wise's "raison d'etre." Wise refers to this central idea: 'Mission Zero,' meaning that they strive to charge their customers as close to zero for cross-border money transfers. When customer prices are framed this way, Wise employees come into work each day looking for ways to drive down the amount they charge in each of their currency corridors. This mentality differs from Wise's fintech competitors, who typically look for ways to maintain or increase their revenue per transaction.

For Wise, lower costs translate to lower prices for customers. As such, each small action to reduce its cost base compounds over time, positioning Wise to have the most efficient cost structure in the industry. Whenever Wise finds ways to lower the underlying cost of a currency route, they automatically return those savings to the customer by keeping their profit margin (%) consistent — more on that below. Wise does not retain these savings for itself despite the appeal of increasing its profits. The company believes that the more savings they return to customers, the more it extends its lead while also driving additional volumes.

In truth, cross-border payments are a commodity. While commodity businesses typically make poor investments, they can generate outlier returns if a company can sustain low-cost leadership in a large market. Costco is an excellent example of such a structurally advantaged player.

Wise's infrastructure, scale, and willingness to earn less per transaction allow them to be cost-advantaged compared to their bank and fintech competitors. While Wise's mission is to make cross-border payments "eventually free," this idea is more conceptual than literal. Wise focuses on charging the lowest amount possible while maintaining its targeted profitability.

2. **Payments Infrastructure – Scale and Systems Designed to Lower the Cost of Cross-Border Transfers**

As mentioned above, Wise offers a better alternative to the correspondent banking system due to its efficient infrastructure. Over the past eleven years, Wise built a global network that services hundreds of currency routes worldwide. Unlike the correspondent system, Wise cuts out costly intermediaries, realizes the benefits of scale (through payment netting, batch processing, and negotiating power), and builds systems that automate and anticipate the backend processes necessary to facilitate these transactions. As a result of these advantages, Wise delivers faster, cheaper, and more transparent payments.

Most fintech competitors in cross-border payments use commodity infrastructure built by someone else, such as a third-party aggregator like CurrencyCloud or Thunes. Meanwhile, Wise built its network to remove “margin stacking” and operate at a lower cost.

When Wise enters a new geography, it either partners with a payment service provider (PSP), a local bank, or an existing global bank partner to develop a local presence. These infrastructure providers offer a quick “beachhead” to begin serving customers locally. At this early stage in a new country, customer prices are the highest because their scale is limited, and they rely heavily on service providers to deliver their service. As Wise grows in a country, it can negotiate with local partners by signing on other banks/PSPs, forcing them to compete on pricing.

At the same time, when Wise enters a new country, they simultaneously begin working toward direct integration with that country’s central bank. While direct integration can offer transfer costs that are up to 10x cheaper than bank infrastructure, it requires significant upfront investment and time. For example, in the United Kingdom, Wise is part of the Faster Payment Service (FPS), and in Singapore, it leverages the Fast and Secure Transfer (FAST) payment system. Wise was the first non-bank financial institution to integrate locally in both countries and has many other central bank integrations worldwide. Wise does the hard work others aren't willing to do to deliver better service and the lowest prices.

As Wise grows, they realize scale benefits in its fixed costs due to unified backend operations in treasury management, customer service, and compliance. Since Wise is moving money from one Wise-held account to another, their systems have better visibility, are more predictive, and Wise can automate steps around treasury management, compliance, and reconciliation. These automated systems accurately flag which transactions are problematic and require further review and which can clear instantaneously. Today, Wise's systems deliver >50% of their transfers instantaneously and >90% within one business day.

In terms of customer service costs, customers typically seek help if their transfers take longer than expected. Wise's customer service burden is dramatically lower than others due to its high percentage of instantaneous and next-day transfers. Similarly, Wise's payment tracking tool operates like a FedEx tracking system to give customers peace of mind about the status of their transfer.

Wise's scale advantages also exist in their anti-money laundering and know-your-client (AML/KYC) compliance tools. In addition to having more data to feed into their systems, once a compliant framework is honed and predictive, it can also be ported into new geographies.

Data advantages also come from scale since Wise can predict more than 50% of their daily volumes before the transfers are requested. This data allows the treasury department within Wise to optimize liquidity pools for each country, reducing their cost of funds.

These systems and benefits of scale result in a leaner cost structure than their competition and, in the spirit of Wise's culture and mission, lower prices for their customers.

3. **Teams, KPIs, and Incentives – Agile Teams Incentivized to Drive Lower Costs, Faster Transactions, and More Transparency**

Wise runs a highly decentralized and flat structure. Rather than view itself as a single business with ~4,000 employees, Wise structures its teams to operate like hundreds of decentralized, nimble, and interconnected 'start-ups.'

Each Wise product team is either focused on a particular geography or product line, with incremental improvements often autonomously pursued within each group. The only operating constraint these teams face is whether their decisions take the company a step closer toward cross-border payments that are faster, cheaper, or more transparent.

Each currency route or product is measured against a core set of KPIs aligned with Wise's mission. Wise holds teams accountable by transparently sharing these metrics across the entire organization. Each Wise employee can see how their group is lowering (or raising) prices in each period. Such autonomy and accountability allow Wise employees to execute what they believe is the right strategy within their focus area without unnecessary red tape.

Each country has local nuances, languages, and even attitudes toward technology. A local from Japan likely understands how to grow the Japanese market better than someone at their UK headquarters. For example, when Wise first entered Singapore, the Singaporean government required a physical location since pure online players were not allowed. This flexibility allowed the Wise Singapore team to open a small location in a shopping plaza. By doing this, Wise earned the first approval for a fintech to integrate with Singpass, the country's digital ID, which rapidly accelerated their sign-up processes locally, significantly lowering compliance costs. Unsurprisingly, Wise tends to be the first fintech to gain a direct connection to the central bank of a country.

4. Business Model – Lower Prices Drive Higher Profits

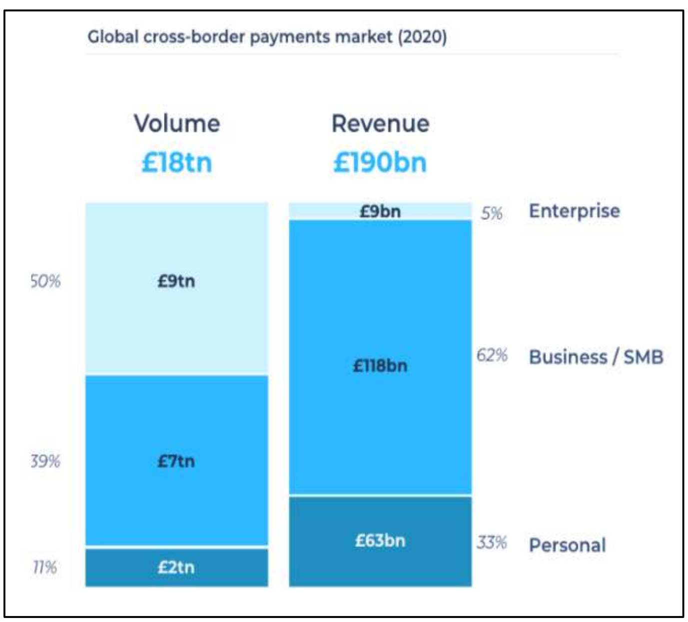
One of Wise's key innovations relates to its business model. While Wise's mission centers around continuously lowering customer prices, Wise's CFO engineered a system that delivers on this objective while achieving excellent profitability. Unlike most fast-growing technology companies, Wise is a healthy and profitable business and has been since 2017. The company does not rely on outside funding for growth and controls its destiny without relying on complicated debt financing or balance sheet tricks. This structure offers Wise shareholders attractive long-term returns.

Wise's financial system dynamically adjusts prices in each currency corridor, resulting in an approximate 20% EBITDA margin (without cross-subsidizing other routes or product lines). Since Wise holds margins constant, savings are automatically passed back to customers through lower prices whenever they drive down operating costs. Wise is making the bet that lower prices drive volume increases that more than offset these price reductions, causing profits to rise in aggregate. Given the large size of this market, this model has worked well so far. This strategy differs from other cross-border companies, which set their prices slightly cheaper than the competition to maximize profitability. Wise always offers the lowest price they can, regardless of what others do.

As Wise rolls out new products and earns money in new ways, it will extend this financial model. For example, Wise Account, which acts as a place for Wise users to store money in multiple currencies, has impressively grown to over £8 billion in deposits. As interest rates rapidly rose this year, this led to windfall profits of as much as ~£100 million. In their most recent update call, Wise’s CFO explained to shareholders that only 20% of this new interest income will flow through as profits. The remainder will reach customers through lower prices or investments in people, technology, and product.

The Remaining Growth Opportunity Ahead

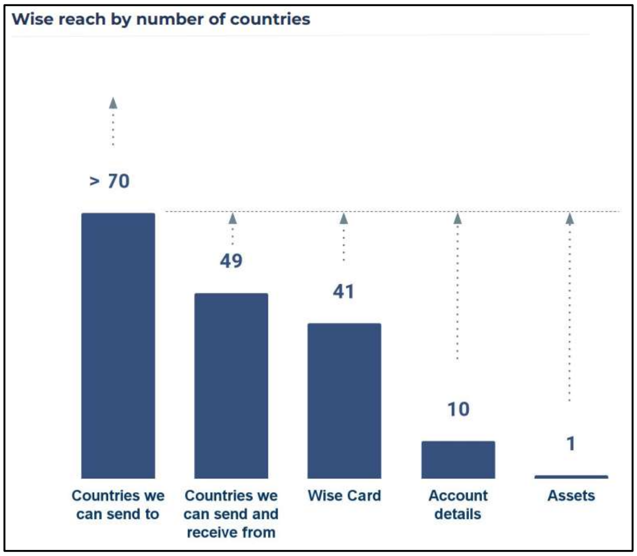
While Wise is already the world’s largest non-bank cross-border transfer business, there is still much to accomplish. Today, Wise only handles ~4% and <1% of consumer and business cross-border volumes, respectively. Viewing the cross-border market opportunity another way, in 2020, financial institutions earned £190 billion from cross-border payments, compared to Wise's LTM revenues of £560 million. Wise still has a significant opportunity to gain market share and build new products around its core capabilities in cross-border transfers.



Source: Wise Company Presentation

Historically, Wise focused on consumer transfers, and they are now successfully moving into the business / SMB vertical, which today represents almost a quarter of their volumes.

Today, Wise is only available in 33% of countries globally, and there's plenty of work left to release its existing product line to its current geographic footprint.



Source: Wise Company Presentation

New Wise Products

Wise recently rebranded from 'TransferWise' to 'Wise' to reflect that they are more than just a transfer company. Wise's trust with customers allows them to release new products that also resonate. The same infrastructure Wise built for transfers is also used for their new products: 'Wise Account,' 'Wise Card,' and 'Wise Platform.'

'Wise Account' allows users to hold more than fifty currencies in one place. In ten of these currencies, customers can apply for local account details – such as an International Bank Account Number (IBAN) – which allows customers to be paid or receive money like a local.

‘Wise Card’ allows travelers to spend like a local wherever they go. When using a typical debit or credit card overseas, travelers typically pay between 1.5-3.5% in FX rate charges. However, with a Wise debit card, they get the same low conversion cost that Wise charges for cross-border transfers.

Finally, ‘Wise Platform’ offers Wise’s infrastructure to others by integrating with Wise’s API or SWIFT connector. Their platform allows challenger banks, fintech companies, and other companies to leverage Wise's low-cost infrastructure and pass these savings on to their users.

Conclusion

In our view, Wise has a long-term ability to compound capital at high rates, is run by mission-driven and aligned founder leadership, and we were able to purchase our investment at an attractive purchase price due to a period of volatility. We are excited about the opportunity that lies ahead for the company.

Closing Thoughts

Thank you again for your partnership. I intend to provide an end-of-year update in early 2023.

Please don't hesitate to contact me with questions or comments.

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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