HAYDEN CAPITAL

QUARTERLY LETTER

2023 | Vol.4

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HAYDEN CAPITAL

February 25, 2024

Dear Partners and Friends,

Our portfolio continued to appreciate in the fourth quarter, finishing the year on a high note. It's a promising first step, as we continue recovering our losses from the year before.

Time Period	Hayden (Net)[1]	S&P 500 (SPXTR)	MSCI World (ACWI)
2014[2]	**(4.9%)**	**1.3%**	**(0.9%)**
2015	**17.2%**	**1.4%**	**(2.2%)**
2016	**3.9%**	**12.0%**	**8.4%**
2017	**28.2%**	**21.8%**	**24.4%**
2018	**(15.4%)**	**(4.4%)**	**(9.2%)**
2019	**41.0%**	**31.5%**	**26.6%**
2020	**222.4%**	**18.4%**	**16.3%**
2021	**(15.8%)**	**28.7%**	**18.7%**
2022	**(69.2%)**	**(18.1%)**	**(18.4%)**
1st Quarter	21.5%	7.5%	7.4%
2nd Quarter	(4.8%)	8.7%	6.3%
3rd Quarter	11.6%	(3.3%)	(3.7%)
4th Quarter	21.3%	11.7%	11.3%
2023	**56.6%**	**26.3%**	**22.3%**
Annualized Return	**9.7%**	**11.8%**	**8.3%**
Total Return			
1 Year	**56.6%**	**26.3%**	**22.3%**
5 Years	**84.9%**	**107.2%**	**74.4%**
Since Inception	**132.1%**	**177.4%**	**107.0%**

What's more encouraging is that we're starting to see early signals of economic & sector-specific improvements. A few weeks ago, the Fed signaled that they believe interest rates have reached

1 Hayden Capital returns are calculated net of actual fees directly deducted from client accounts, for the period from inception (November 13, 2014) to December 31, 2020. Starting on January 1, 2021, reported performance is reflective of a representative account, managed in accordance with Hayden's strategy with no client specific investment guidelines or limitations, made no subsequent investments or redemptions, and remains invested. The representative account paid a management fee of 1.5% and incentive fees of 0%. Clients who elect the performance fee option for their accounts may pay higher fees and therefore realize lower net returns, during years of strong investment performance. Individual returns may vary based on timing of investment and your specific fee schedule. Performance results are net of expenses, management fee and incentive fees. Past performance is not indicative of future results.

2 Hayden Capital launched on November 13, 2014. Performance for both Hayden Capital and the indexes reflects performance beginning on this date.

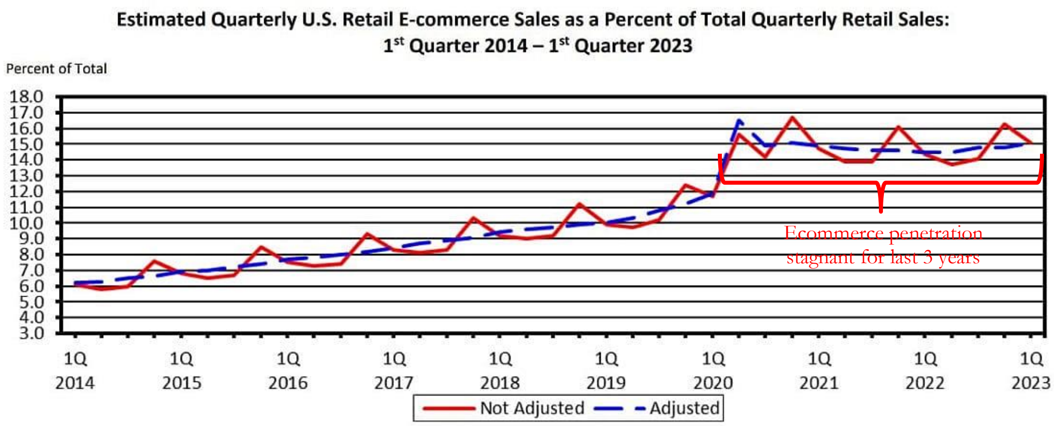
their peak for this cycle. Now the question is just when exactly to begin cutting rates in 2024. The direction is clear, but the magnitude and timing are not.

Elsewhere, we're also starting to see early signs of ecommerce penetration increasing again, after three years of stagnant growth. In the early days of Covid, many (including myself) thought that ecommerce penetration would permanently "step-up" as Covid formed new consumer habits, and then continue growing at its prior rate[3].

While the Covid "step-up" indeed happened, the continued growth afterwards didn't. Instead, the US has been digesting this "pull-forward" demand for the last three years – with US ecommerce penetration stubbornly hovering around ~15% of total retail sales, since late 2020. Many international countries also experienced a similar situation.

Ecommerce Penetration

Source: US Census (LINK)



This is starting to change though, with the harbinger of US ecommerce (Amazon) pointing out accelerating growth in both North America and Internationally on their most recent earnings call. Sea Ltd hasn't officially reported yet, but alternative data providers are calling for ~+23 - 26% y/y growth, compared to just +5% y/y the previous quarter[4]. The company commands almost half the market in ASEAN, so this is a good indication for the region.

Lastly, if there's anything more symptomatic of the end of a cycle and the beginning of a new one, it's bankruptcies and buy-outs. And we witnessed quite a few in the public markets recently.

Notable bankruptcies (including quasi-bankruptcies – those on the verge of bankruptcy, if not acquired), include Farfetch, WeWork, Wish, Bird, Blue Apron, and SmileDirectClub. According to Carta, it was the most difficult year for startups in at least a decade (LINK).

Buy-outs are also an important signal in a market downturn, as it shows 1) private acquirers think valuations have declined enough in the public markets, that they can find great deals (signaling a market bottom); 2) that the public shareholders are frustrated enough with performance or lost confidence, that they're willing to part with their stakes at low prices (capitulation), and / or 3) the financial markets are open enough, that the acquirers can finance these acquisitions via debt

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[3] The thesis was that many people who were hesitant to use ecommerce before, would now be "forced" to adopt these new habits during Covid. After recognizing the benefits (greater selection, cheaper pricing), they would be unlikely to go back to their prior offline habits.

[4] MScience, Yipit Data

or equity at reasonable prices (stable capital markets). Notable examples of these include Alteryx, Rover, Splunk, Coupa, One Medical and Docusign (rumored).

All of these signals seem to indicate that we've put the worst behind us. The world has recovered from a turbulent couple of years, and starting to return to a more normalized environment.

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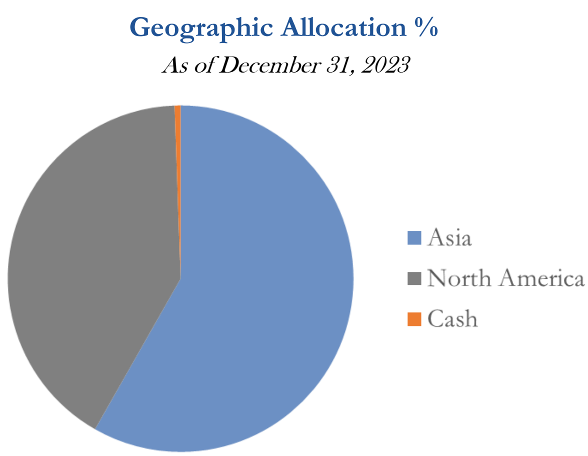

Our portfolio appreciated +21.3% during the fourth quarter of 2023, versus gains of +11.7% for the S&P 500 and +11.3% for the MSCI World indices. This brought our annualized return since inception to +9.7%.

We ended the year with approximately ~58% of assets invested in Asia, ~41% in North America, and the remainder in cash.

We've also added a couple of new tracking positions this quarter. We've described the thinking behind these types of positions before, and have incorporated this "tool" several times in our history[5]. Essentially, these are situations where we've concluded the majority of the research process, but there still remains a few unanswered questions (some of which are too early to have a clear answer).

Mitigating this uncertainty though, are both low prices (which allows us to quickly reverse our decision with minimal risk of loss) and the presence of near-term catalysts (which potentially could create a sharp re-rating if the "answers" unfold in our direction). Psychologically, these small positions also force us to pay closer attention to the situation, with capital on the line, and thus react quickly when new developments break.

We'll continue to monitor these situations, and will provide further updates if we invest more substantial amounts of capital behind them.

[5] Originally outlined the rationale for this portfolio management "tool" in our Q3 2018 letter (LINK).

Late-Mover Advantage

"Let you start first, and I will go for the kill with the model you have explored, in a market you have educated. In your eyes, I am your competitor; in my eyes, you are my tool."

– Duan Yongping (founder of BBK, mentor to Oppo, Vivo, Pinduoduo, and J&T)

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"People often talk about 'first mover advantage.' But focusing on that may be problematic; you might move first then fade away. More important than being the first mover is the last mover. You have to be durable."

- *Peter Thiel (co-founder of PayPal, Palantir, and Founders Fund)*

If you read any business strategy book, one of the first concepts you'll come across is "first mover advantage". It's the idea that a company gains an advantage by being the first to market – thereby allowing it to establish strong brand recognition and customer loyalty, before competitors enter the market. It's so ingrained in business culture, it seems many business leaders focus on *how* to be the first entrant – instead of questioning whether it's a worthwhile goal at all.

In theory, being the first mover is advantageous when there's strong demand for the product, and you're the only firm able to feed that demand. This typically means pricing power, and enormous initial profits. Even if competitors emerge later on, that initial burst of super-normal profits might be enough to justify the costs of rushing to the starting line.

But what if the industry is such, that instead of huge initial profits, it requires years of losses to gain the scale necessary to be profitable? And the earlier you are, the bigger the losses?

If first-mover advantage gives you an initial lead, it's other competitive advantages like network effects and brand recognition that provide the ability to *stay* ahead. But what if these secondary advantages take *years* to build – such that the initial lead gained isn't much of a moat at all? You might have a head start, but your moat is still narrow and vulnerable to attack.

Is being a first-mover really the golden prize we're taught to believe? And in today's fast-moving world of technology and relatively cheap capital, has it become much easier to close this initial gap?

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The concept of "first-mover advantage" was first published by Stanford professors, Marvin Lieberman and David Montgomery in 1988 (LINK).

In that paper, they described the key sources of first-mover advantage coming from 1) technological leadership, 2) controlling scarce resources early, and / or 3) increasing customer switching costs.

Technology leadership can come from being further along the "learning curve", where unit production costs fall with increased output (i.e. economies of scale). By being first and gaining volume, theoretically you'll always be able to offer lower prices than competitors. Additionally, technological leadership can allow the first-mover to patent these technologies, which legally fortifies the moat.

Controlling scarce resources can be in the form of physical assets – raw materials / minerals, distribution (limited shelf-space), prime geographic locations – or in the modern world, access to digital resources like proprietary datasets, or user attention (monopolizing a user's limited free hours in a day).

An example of this would be the aluminum company, Alcoa. In 1886, Alcoa's founder discovered a drastically cheaper way to produce aluminum, soon establishing one of the world's first scaled aluminum companies. By pioneering this process, they were also the first to realize the importance of bauxite, a key component in making aluminum. Alcoa was thereby able to corner a vast supply of bauxite early on (along with controlling each subsequent stage of production) and prevent competitors from entering the market for decades.

Or alternatively, consumers will sometimes notice store or restaurant chains rapidly launching dozens of locations at once, in a concentrated region[6]. It might seem like thoughtless expansion at first. But one reason for such blitz-scaling / "clustering" is to control the scarce resources – prime physical locations – before competitors can enter.

It might be sub-optimal for each induvial store's profits, but having such a geographic monopoly might generate higher profits in the long-term for the region as a whole. By crowding the market, it makes it uneconomical for potential competitors to try to open their own stores inside the territory[7]. In addition, there are scale advantages by leveraging shared marketing, supply chains, etc.

The final advantage is increasing customer switching costs. This results from the first mover establishing a brand within the new market, which endears consumer loyalty. For example, Kimberly-Clark and Kleenex invented the facial tissue category and established the brand early. Why would a consumer risk choosing a new tissue brand, when Kleenex's are what they've always relied on? The fear of dissatisfaction of switching to another brand, along with relatively little savings from switching, leads to the ease of just going with the incumbent.

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All of these advantages mentioned are valid – but I'd just argue they are most applicable for a slower-moving, analog world.

First mover advantages are strongest in gradually evolving industries, as it allows the incumbent time to keep up to date with challengers. If consumer expectations don't evolve, it makes it

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[6] It's a popular tactic among Asia's food & beverage chains.

[7] There are fixed costs in running stores, with only a limited amount of traffic. Splitting this traffic across two competitor locations would make it unprofitable for both entities, thus deterring the late-mover from entering in the first place.

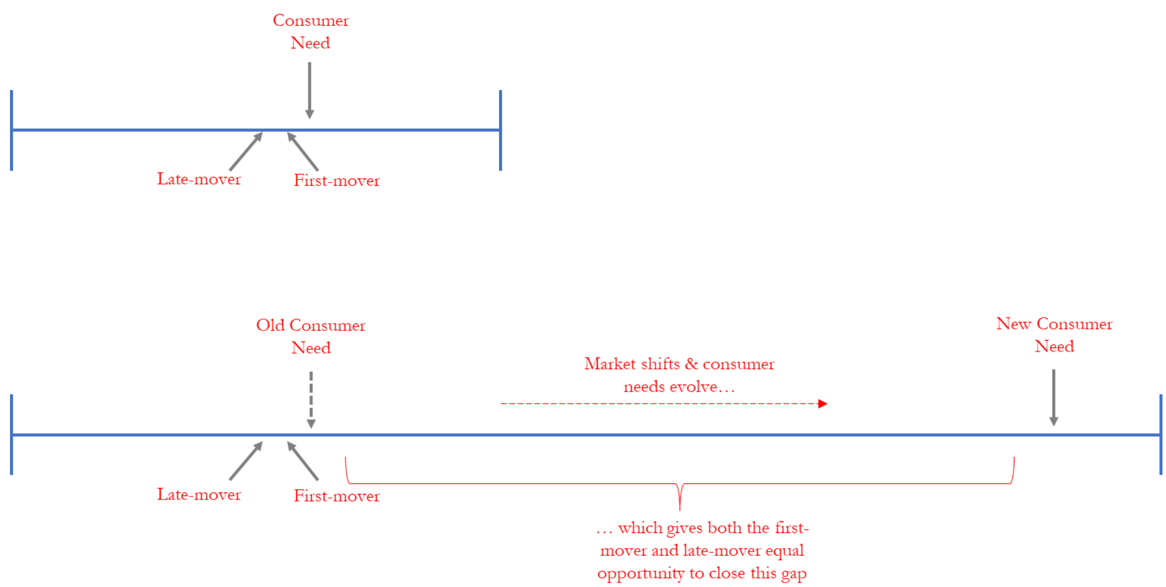
This is different than the same company owning the stores nearby, since you have control over pricing and decision-making – this collusion avoids the "race to the bottom" that might occur with two independent competitors.

harder for late entrants to differentiate themselves, since consumer needs are already satisfied by existing brands.

But when entire markets shift quickly, both the first mover and late movers are required to evolve rapidly too. This means the gap between what customers want, and both the first mover and late mover's products widens – thus diminishing the early lead advantage that the incumbent had.

Slow-evolving vs. Fast-evolving Markets

Source: Illustrative example



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As our world grows increasingly digital, we should re-examine all of these concepts we previously took for granted.

For instance, distribution (such as shelf-space) is unlimited in a digital world. Locations have become commoditized – one website URL is just as "prime" an address as another. Even on brand recognition, robust reviews have replaced brand marketing, in gaining customers trust. Consumers are more willing to experiment with an unknown-brand, but one with thousands of positive reviews. In fact, ~60% of Amazon's sellers are independent, many with their own niche brands (LINK).

Technological leadership and the associated economies of scale, might be the most persistent competitive edge in a digital world. But arguably, even this advantage is at risk. Gaining an initial "head start" doesn't provide the upper-hand it once did, while the ability to retain users and keep them coming back is a better predictor of business durability. There are several reasons for this.

There have always been high costs associated with being first to market. Not only is cutting-edge R&D and establishing a new brand expensive, but also the first entrants need to bear the full cost of *educating* the market, in the first place.

Early Advertisement for Apple II

Apple Computer, 1979 (LINK)

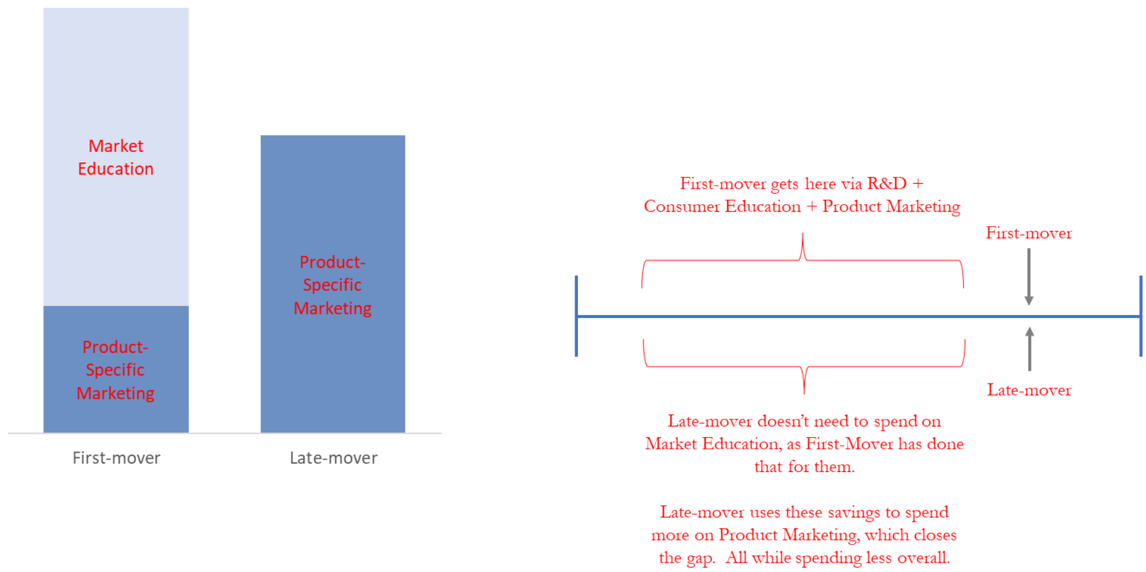
For example, when you look at early ads for the personal computer, the ads answer questions like "Who uses personal computers?" – i.e. making a significant effort educating consumers why they need one in the first place. This is obviously a much harder (and expensive) marketing strategy, than if consumers were already familiar and convinced of a computer's benefits, and simply needed to be convinced of "Why should I choose an Apple II vs. a Commodore?".

Additionally, an initial lead is meaningless if you don't have a method for quickly locking in these customers. It's the worst if you spend all this money and effort educating the world about your new product and industry, only to watch competitors re-acquire (i.e. steal) these customers at a fraction of your initial costs.

By educating the market, it not only makes it easier to attract customers for the first mover, but also for potential competitors. And instead of wasting money on market education, the late-comers can redirect their *entire* marketing budget to acquiring new customers – thus getting to scale more efficiently and closing on the first-mover's lead.

Late-Mover's Efficient Marketing Spend[8]

Source: Illustrative example



Another problem first-movers face, is that there's always going to be wasted resources, when trying to figure out what consumers *really* want for the first time. What features are customers willing to pay for? How should you balance higher quality materials vs. lower prices? What marketing strategy resonates with customers? You often won't know the answers until you experiment and test the market – the costs of which fall purely on the first mover.

As a late-mover, you don't have these issues. In fact, theoretically your capital is much more efficient, as you benefit from learning all your competitors mistakes and experimentations (and on their dime). Your capital can then be productively used to create a product / service pinpointed to the market's exact needs.

On top of this capital efficiency, it's possible the late-mover will have access to *larger* amounts of capital too!

When you're building a new industry, the market's demand for that product is unproven. There will be fewer capital providers willing to fund such a bet. And those that do, will demand a taxing return on their capital, to compensate for such risk. The returns on this capital will likely be lower for the first mover, given that much of it will inevitable be wasted on failed experiments and educating the market at large.

If the initial products or experiments flop, it becomes even harder (and more expensive) to raise additional capital to try again. The first-mover's reputation might be in question, as investors ask whether the failed experiments were just a natural part of innovation, or whether it's due to

[8] For those who have seen the Fast & Furious series, I like to think of this excess product marketing spend as injecting "nitrous oxide" for the company (LINK). It gives the firm a temporary speed-boost, to catch up with the first-mover. It's only a quick-fix though, and not sustainable long-term.

management's poor judgement. On top of this, the company must shoulder the debt of paying back investors for those initial failures, acting as an anchor on the company's ambitions.

As time progresses, the first-mover's existential risk increases.

It used to be that being first to market could result in initial super-normal profits, which would more than compensate for these large risks. But as mentioned before, that's no longer the case in a digital world. That initial lead is harder to defend, and the potential pay-offs farther in the future.

Given the above, it's often better to be a late-mover in modern business. The late mover is unencumbered by any of these issues. They can raise capital for a market that's already been proven. And since they don't need to educate or groom consumers, the marketing efforts generate immediate results. This means high capital efficiency and thus a lower cost of capital.

The company also has a "clean" reputation, while also having more data about the market, which allows it to take more "shots on goal" with higher odds of hitting the consumer's target desires.

All of this makes it much easier for the late-mover to close the first mover's initial lead, and ultimately surpass them. These advantages are further pronounced, if the late-mover is already a well-known company in adjacent fields, providing them further with reputational, capital, and size / man-power advantages.

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Many of the most popular internet companies today, are in fact late-movers.

Book Stacks Unlimited (Books.com) launched in 1992, two years before Amazon (LINK). Netscape had tens of millions of users, by the time Google launched in 1998. And MySpace was the most popular social network before Facebook came along.

We've witnessed several successful real-life examples of this within our own portfolio too.

For example, Sea Ltd launched its Free Fire mobile game months after PUBG and Fortnite already popularized the battle royal genre. By learning from the mistakes of PUBG and Fortnite, which were optimized for wealthy / developed markets gamers playing on expensive consoles or gaming PCs, Sea Ltd optimized for the billions of cheap mobile phones in emerging-markets.

Additionally, Youtube videos of gamers playing PUBG or Fortnite educated gamers on this new genre – teaching them the format and creating "FOMO" among gamers unable to afford an expensive computer or gaming console. The market for a battle royal style game was already proven / de-risked by competitors.

Free Fire launched into this pent up demand, leveraging their competitor's market education efforts, and were quickly embraced by these gamers who could only afford a mobile phone. Free Fire quickly surpassed both PUBG and Fortnite by 2021 (LINK).

Pinduoduo is the "King" of late-movers, and has successfully done this on several separate occasions. The story of their first launch into China's ecommerce market is already that of legend. Created 16 years after Alibaba, and at a time when industry experts already assumed the solidification of Alibaba and JD's market shares.

The mobile phone brought hundreds of millions of China's lower-income consumers onto the internet. And this new consumer class experienced a wide gap between what they needed, and where existing offerings were – thus putting both first-movers and new challengers on the same starting line. Pinduoduo used this window of opportunity to become the second largest ecommerce firm in just eight years, and almost ~1 Billion monthly users.

But what's less known is Pinduoduo's next venture – Duoduo Grocery. There were several companies already doing online grocery services when Duoduo Grocery launched. Xingshen Youxuan was the original pioneer of the community group-buying model, and had already raised over $1 Billion at that time (and another $4 Billion in the years after; LINK). MissFresh, founded in 2014, had a front-warehouse model and had raised ~$1.6 Billion by the time they IPO'd in 2021 (LINK).

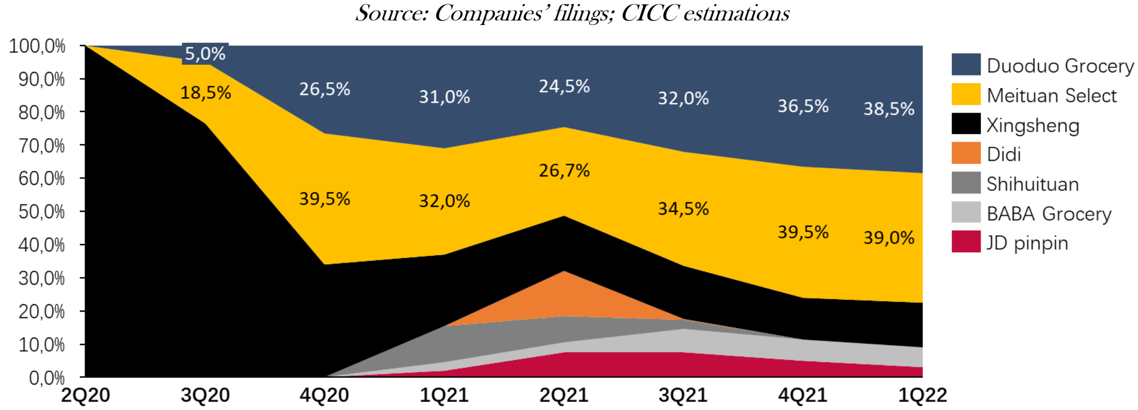
Large tech companies also got into the game, including Alibaba (Hema, 2015), JD (7Fresh, 2018), and Meituan (Select, 2020). Cumulatively, many billions were spent educating the Chinese consumer on the various benefits of buying their groceries online.

But the problem is that even though the first-movers built early market share, they had trouble retaining it. Consumer switching costs were low / non-existent, and economies of scale didn't get shared with the customer. Whether there were 100 thousand users or 100 million, the service was the same for the end user.

Pinduoduo used these early startups as "R&D" – studying what business models worked, and which regions were most profitable. When it was clear that the business could be profitable under the community-group buying model, Duoduo Grocery quickly moved to the starting line. There were no resources wasted figuring out whether to pursue a community group-buying or front-warehouse model. Or how many orders per pickup point were needed to be profitable. Since the market was "educated" by competitors, they didn't need to keep injecting capital as they waited for the market mature / embrace the service.

Duoduo Grocery Gained Market Share, at the Expense of Incumbents[9]

Source: Companies' filings; CICC estimations



Within two years, Pinduoduo's level of efficiency and cost optimization, along with their traffic advantage, led them to the front of the pack. Most other startups had gone bankrupt, exited the

[9] Chart from our Pinduoduo Memo, originally published in January 2023 (LINK).

business, or significantly scaled back. It's our understanding that Duoduo Grocery's margins surpassed competitors within two years of launching.

In the words of Duan Yongping, these early startups saw Duoduo Grocery as a competitor, but really they were just Pinduoduo's "tool". In today's world, the better bet is often on the late-mover, not the first.

PORTFOLIO REVIEW

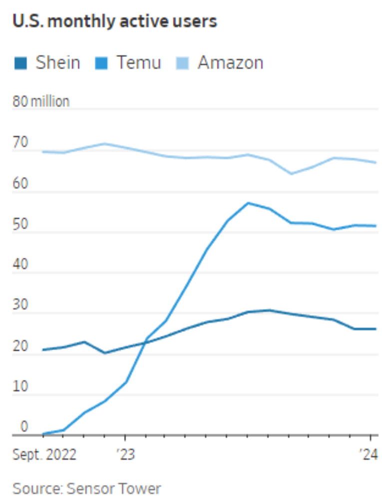
Pinduoduo (PDD): Pinduoduo has surpassed our expectations since we first wrote about it a year ago (LINK). Revenues in 2023 are expected to be +81% y/y higher than last year, and free cash flow up +71% y/y too. This is despite an ongoing multi-billion dollar annual investment in Temu, which is depressing overall free cash flow. Meanwhile the stock trades at ~13x 2023 EV/FCF and ~7.5x on estimated 2025 FCF[10].

The biggest surprise since a year ago, is just how successful Temu (PDD's international ecommerce platform) has been. It's exceeded our loftiest expectations, achieving ~$15BN of GMV in its first year of operation, and with plans to double that to ~$30BN in 2024 (LINK)[11].

According to Sensor Tower, the company has ~51M monthly active users in the US, compared to Amazon's ~67M and Shein's ~26M (LINK).

Temu's Monthly Active Users

Source: Sensor Tower, Wall Street Journal



[10] 2025 enterprise value assumes ~$29BN of additional cash accumulated over the next two years.

[11] The company doesn't disclose official figures. But we've seen sell-side estimates generally range between $14 – 17 billion.

Some credit card data even suggests Temu stole ~14% market share from the US discount stores (Dollar General & Dollar Tree; LINK). And Facebook stated on their last earnings call, that China-based advertisers (such as Temu and Shein) represented 10% of their total revenue[12].

Even Amazon discussed lowering their take-rates, and adding a second "buy-box" with a lower price (in exchange for slower shipping), in response to the company (LINK). It's a testament that you're doing something right, when even Amazon feels the pressure. Almost half of Amazon's third-party merchants are based in China.

However, Temu's rapid ascent has drawn out its own share of naysayers too. Critics argue that it's not hard to buy market share, when you're spending billions of dollars a year. And given what we talked about above, they're right. This enormous buying up of market share and users simply closes the gap for the late-mover, eliminating the head-start advantage of the incumbents. But it's not a long-term fix.

Ecommerce business models have low switching costs. It's not hard to get new users by giving away free money. It's much harder to get them addicted to your platform, and keep them coming back month after month. There's a fine line between wasted marketing dollars, and savvy investment. So will it be the former or the latter?[13]

Recently, critics have pointed to Temu's Superbowl ads this year, estimated to cost ~$42M, as evidence of wasted spending and a reckless internal culture. But I'd argue that what may look like reckless spending at a superficial glace, hides a logical method to the madness[14].

Firstly, it's important to understand why Temu spent so much money on marketing in the first few months of existence. For example, when they bought Superbowl ads a mere six months after launching last year, and drew similar skepticism.

The reason is PDD's platform is extremely automated and algorithmically driven[15]. And since they were entering the US market for the first time, they didn't have any data on which to train their algorithm. The platform's secret sauce is its recommendation engine – how would they know what American consumers wanted, or what products to recommend, if there was no purchase history? Certainly, US consumers have different habits and product correlations than their Chinese consumers.

So, a major reason for the company's "marketing blitz" those initial months, was to train the recommendation engine. And we heard that they internally thought they needed at least 100 million cumulative orders to have an adequate algorithm.

The alternative reality would have been to grow the platform organically and slowly. But in that scenario, it might take *years* to reach that 100 million order threshold. And for those early users, it would be a sub-par experience, likely causing those users to churn immediately. Without repeat

[12] Meta Q4 2023 earnings call (LINK).

[13] I'd argue it's still too early to know for sure. For this reason, our internal PDD valuations are based only on the Chinese operations. The Temu business is still a "call option", and likely won't be "known" for another couple years.

[14] And considering Temu's multi-billion dollar marketing budget, $42M is just a drop in the bucket versus their total spend.

[15] The running joke is that even PDD's human employees operate like robots – working in a "highly paid, white collar factory" with a repetitive, narrow set of tasks / KPIs to hit (LINK).

customers, and likely negative publicity about how poor the service is, the platform would never learn their preferences and would never improve. Thus, putting the business in a negative cycle.

Since Pinduoduo had already decided to enter the US market, they had no other option but to spend large sums on attracting as many users (and training the algorithm), as fast as possible. It would have been wasteful *not* to.

And last year's Superbowl ads worked. Company executives stated that Temu brought in ~20M new users through that period, costing ~$1 per new user (LINK). Alternative data providers show similar new user growth numbers as well, thus corroborating this statement.

If correct, this customer acquisition cost was just 1/20th of what it historically cost to gain a new user through other channels, like social media ads or on Google[16]. More importantly, it accelerated Temu's cumulative order count past the 100 million mark. More users didn't just grow revenue, but strengthened the recommendation engine too.

This is an example of economies of scale leading to product benefits (better algorithm), which leads to user benefits (higher retention rates, due to better product), which then leads to better financials (improved economics from higher LTV / CAC, and lower per order costs).

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Monthly active user growth slowed in the second half of last year though, and the critics are pointing to that as proof that the platform is already declining. A flash in the pan after its explosive start. But what a lot of observers miss is that this was a conscious decision, as management is scaling back its marketing efforts in the US.

Our channel checks starting last summer, already suggested that the company was pulling back on US marketing spend.

The company thought that they had already acquired the "low-hanging customers" (already have over ~50M monthly active users versus Amazon's ~70M), and would need to shift its focus on getting these existing customers to order more, and more frequently.

This is a function of creating a better product – faster shipping times, offering a wider range of items, etc. Blasting users with ads won't solve any of these issues. Instead, the company is opening warehouses in the US, signing deals with express sea shippers, and allowing local sellers to list on the platform later this year (LINK)[17].

As such, Temu decided to shift its marketing efforts to new markets in Europe and East Asia. This is corroborated by LatePost, which similar reported last October "…Temu's management has recently lowered its marketing expenses for the US market and plans to transfer this part of the expenses to other regional markets" (LINK).

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[16] The executive stated that historical CACs were ~$21 or higher (LINK).

[17] Although most of these "local sellers" will likely still be Chinese sellers who have inventory in US warehouses (Amazon, Wayfair, Walmart, etc sellers). Temu gives them a "liquidation channel", instead of having to ship their inventory abroad or discarding it. It's estimated that the approximately half of Amazon sellers are Chinese (LINK).

You can see signs of this in the Sensor Tower data above too. Slowing US new customer growth coincides with Temu launching its European, Japanese, and Korean websites. Within just half a year, Temu managed to generate half its total GMV *outside* the US.

Going forward, Temu plans to focus on serving these remaining ~50M American customers[18]. The company's goal is to get those users who stay, to spend over $50 each time they shop, and to place 2.5x orders per month[19].

Temu has already made good progress so far, with order values increasing from ~$25 to ~$40 over the last year. Customer acquisition costs also declined to ~$15, and we estimate logistics costs at currently ~$10 per order. With gross margins now at ~30%, and combined with $40 AOV's, it means the company is likely break-even on orders from repeat customers.

If the company can hit its targets, we wouldn't be surprised if Temu's US business reaches profitability (including new customer acquisition spend) within the next year or two.

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Critics can fault Temu for a lot of things… selling lower-quality items, being environmentally unfriendly, having long-working hours, or ruthlessly squeezing their factory merchants. But it's hard to argue that they're wasteful / inefficient, if you truly take time to understand the company's actions.

Back in 2018, I had similar doubts about Pinduoduo's strategy too (LINK). I wrote in our Q2 2018 letter:

"Turn on the TV, and you'll see a ton of advertisements / product placement. What may look like a distraction / turn off to Westerners (ie. "why would anyone ever want to watch a show with this many ads or brand sponsorships") is just the norm to Chinese viewers. For example, I was watching a random Chinese reality TV show, and the entire show was basically an advertisement for Pinduoduo – the logos on the screen, the name tags, the pillows in reality show's house, where the reality star got his deliveries… the entire show was sponsored by the company… ***so much for Pinduoduo's claim of an "efficient" customer acquisition model via social referrals… if they were able to acquire customers so rapidly and efficiently via other advertising channels, it's doubtful they'd do this.****"*

Obviously, I was wrong about those observations, and have learned a lot watching PDD's execution over the years. The company created ~$150 Billion of shareholder value, and ~$28 Billion of cumulative free cash flow since then. I just fear that many critics today are making the same mistake, without fully understanding the playbook, as I did back then.

It's still too early to declare victory, and is why we still view Temu as a call option within the larger Pinduoduo empire. But at its current pace, it looks like the company *just might* pull off building a multi-billion dollar profit business for the third time.

[18] It's natural to see some fluctuation in this number in the short-term though. Some customers who joined to solely take advantage of the deep new customer promotions, will naturally leave the platform.

[19] According to private expert network interviews (LINK).

CONCLUSION

A couple weeks ago, I announced our relocation to Los Angeles. For partners who missed it, you can find a copy of the announcement here (LINK). Thank you to everyone who has reached out since then, to wish well and welcome us to California.

I'm excited to see our West Coast-based partners more frequently, as well as the teams leading our West Coast-based investments. I don't anticipate much to change, except for our mailing address and new office view. It's just a new chapter, to Hayden Capital's (hopefully) multi-decade story.

On that note, I plan on being in San Francisco and Silicon Valley in late March. I'll be in Omaha for the annual Berkshire Hathaway meeting in early May afterwards, and then back to New York likely in late May. Please shoot me an email, if you'd like to meet up while I'm in town.

I'm also excited to welcome Steven Cao, who is joining our internship program this semester. Steven is a student at the University of Virginia and has previously worked with Legatum and the UVA endowment. Steven is currently busy "turning over rocks", with the hope we'll find a gem or two in the process.

Lastly, partners will notice that the "investor letters" section is back up on our website! We are in the middle of re-uploading all our investor materials. Partners will remember that we were forced to take them off the website in late 2022, due to the new SEC marketing rule. Our compliance team has worked tirelessly over the past year, reviewing hundreds of pages of older materials, and have finally given the green light to start putting them back online.

I've always believed in full transparency and public accountability to our partners, so I'm excited to have them back up. Having our historical materials easily accessible is one of the best ways to understand how our thinking has evolved over time as well. To understand what has worked, what hasn't, our initial thesis, and the research process that led to thinking that at the time.

Plus, I've always found it invaluable to have the materials public, so that other investors can see our thoughts and offer any counterpoints / spirited debates on aspects we may be missing. I've always been puzzled by why other funds consider their research "proprietary information".

Once you establish a position, shouldn't you want open debate around the thesis to understand differing perspectives? The fundamentals are destined to play out, regardless of whether the research is public or not. Shouldn't you want to increase your odds of understanding that "ultimate truth" sooner, rather than later? This "open feedback" has been a valuable part of our investment process over the years.

Partners will notice that only our historical investment memos, conference presentations, and interviews are available for now. Compliance still has some more work to do on our historical letters, but I hope to have those back on the site later this year too.

View from Hayden's New Office

6565 Sunset Blvd, Los Angeles

"Nature loves courage. You make the commitment and nature will respond to that commitment by removing impossible obstacles. Dream the impossible dream and the world will not grind you under, it will lift you up.

This is the trick. This is what all these teachers and philosophers who really counted, who really touched the alchemical gold, this is what they understood. This is how magic is done. By hurling yourself into the abyss and discovering it's a feather bed."

- Terence McKenna (h/t to Ahmed H.)

Sincerely,

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