2H 2024 Investor Letter | *March 11, 2025*

Dear Investor,

For the twelve months ending December 31, 2024, Bonsai Partners Fund, LP, grew 9.7% net of fees and expenses. The S&P 500 Total Return Index grew 25.0% during this period.

Bonsai Partners Historical Returns Summary

	2024	2023	2022	2021	2020	2019	2018	Since Inception	Annualized *Since Inception*
Bonsai Gross Return	**10.8%**	**22.7%**	**-26.5%**	**-13.9%**	**277.9%**	**60.3%**	**-17.6%**	**329.3%**	**26.5%**
Bonsai Net Return	**9.7%**	**21.5%**	**-27.3%**	**-14.8%**	**247.9%**	**56.1%**	**-17.7%**	**268.8%**	**23.5%**
S&P 500 Return	25.0%	26.3%	-18.1%	28.7%	18.4%	31.5%	-8.6%	136.7%	14.9%

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.

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Pattern Recognition and Forging Your Own Path

Pattern recognition plays a critical role in investing—it helps investors narrow down opportunities and influences the prices they are willing to pay. By applying lessons from history, patterns reduce uncertainty and increase the likelihood of successful outcomes.

However, while “mental models” offer significant benefits, they also have drawbacks: easily recognizable patterns often carry higher valuations due to their perceived reliability. Patterns can also be manipulated. For instance, when a startup describes itself as "the Uber for X," it invokes a well-known success story to trigger favorable associations. This familiarity creates comfort and confidence, leading investors to accept higher valuations where it may not be merited.

As a mental model becomes widely accepted, investors increasingly pull forward anticipated future success into today's valuation. Unfortunately, higher prices today reduce the value of cash flows generated tomorrow. As the last in line, public equity investors must remain mindful of how widely adopted the mental models they rely on have become, recognizing that as these models mature, their potential to deliver outsized returns typically diminishes.

Studying "Hundred Baggers"

I spent years studying a database of the best-performing stocks of all time, expecting to uncover patterns to help me identify future winners. Instead, it was mainly an exercise in frustration.

As I returned to the data multiple times with vigorous excitement–each time with new methods to apply–I was convinced that I'd finally cracked the code that would uncover deep insights. Instead, despite numerous attempts and approaches, I could not identify the common threads that tied exceptional performers together.

Then, one day, like many epiphanies do, it just clicked. I even laughed at its simplicity: I realized the pattern these outlier companies shared was **the absence of a pattern!**

By definition, a publicly traded stock can only deliver legendary returns if it is not appreciated as great in advance. Once a company unexpectedly achieves an enviable track record, investors rush to identify the underlying causes and distill the "ingredients of success" into a repeatable formula. This new mental model is then applied to similar-looking companies, increasing the valuation of these analog businesses.

This "succeed-distill-copy" cycle demonstrates how mental models mature, and it's why the next legendary stock is unlikely to look like one that succeeded before it. Whenever a company enjoys a well-understood advantage, consensus gives it credit in advance, reducing how much return can accrue to later-stage investors.

Ironically, if your goal is to identify truly outlier opportunities, what you're looking for isn't a pattern but the absence of a pattern!

This thought exercise highlights the importance of maintaining independence and thinking for oneself as a public market investor. Our sweet spot, therefore, lies in identifying valuable patterns that others haven't recognized yet but are likely to appreciate later.

To be clear, I am not saying that ideas that rely on conventional wisdom cannot yield outsized returns. Instead, many no-brainer ideas can deliver good results, and we, too, own such investments. Instead, the key idea is that the truly outlier opportunities require uniqueness. If we are fortunate enough to find them, such ideas will only represent a limited portion of our capital but hopefully will represent an outsized proportion of the returns we generate. While we will own our fair share of “conventional” ideas, I expect the most significant rewards will come from recognizing and investing in opportunities before they become obvious.

Conventional wisdom suggests studying past successes is the best way to identify the next big idea. Ironically, though, **while this approach increases the odds of identifying something good, it also reduces the odds of finding something great.** If you imagine the distribution of potential returns of an investment resembles a bell curve, situations that rely on widely accepted patterns have a thinner and truncated right tail of outlier outcomes and increased height around “the bell” of above-average outcomes. Although it feels safer to stick with tried-and-true methods, outlier opportunities come from forging your own path instead of following in someone else’s footsteps.

The late Professor Joseph Campbell frequently discussed going your own way through the "hero's journey" often present in stories and myths. There are some parallels between this idea and investing. Expanding on this idea, Campbell once said:

> *“In the story of Sir Galahad, the knights agree to go on a quest, but thinking it would be a disgrace to go forth in a group, each “entered into the forest, at one point or another, there where they saw it to be thickest, all in those places where they found no way or path.”*

Where there is a way or path, it's someone else's way. Each knight enters the forest at the most mysterious point and follows his own intuition.

...In that wonderful story, ***when any knight sees the trail of another, thinks he's getting there, and starts to follow the other's track, he goes astray entirely."***[1]

[1]Campbell, Joseph (1991). A Joseph Campbell Companion: Reflections on the Art of Living. Selected & edited by Diane Osbon.

A core belief within Bonsai Partners is to seek great companies **that are overlooked due to "barriers to investment."** These barriers keep prices sensible and allow us to earn an outlier result if we are right about our thesis, allowing us to forge our own path.

While "barriers to investment" present themselves in many ways, we consider the absence of a widely understood mental model as one of its most valuable forms. If we can identify hidden insights before they become apparent, we ensure that exceptional business results also translate into investment results. When we are fortunate enough to spot a powerful mental model before others, we intend to exploit it. Some of our investment cases shared in previous letters illustrate this process.

The Decision to Sell Greentown Management

Greentown Management was the most challenging investment I've ever managed. While our analysis uncovered several unique insights early on, and the business compounded at high rates during our ownership, the investment still did not meet our expectations, which is frustrating.

At the outset, we identified that Greentown Management had multiple attractive attributes: it was asset-light, founder-led, and enjoyed significant growth potential. The company consistently generated strong returns on capital and had attractive cash flow characteristics. Further, when we invested, its valuation was attractive at ~12x trailing earnings. From 2020 to 2023, Greentown Management doubled its profits, representing a ~25% annual compounded growth rate, and cumulatively paid over 1 RMB in dividends per share relative to our earliest purchases at ~3.5 RMB per share. Despite these dynamics working in our favor, we still did not obtain a good result.

Our investment thesis broke down following the company's interim 2024 results when many of the attractive financial and qualitative attributes we appreciated about the company rapidly deteriorated without a clear explanation. As a result, we swiftly exited the position.

Reflecting on unsuccessful outcomes is a challenging but important part of investing. The hardest part is balancing the need to identify mistakes that shouldn’t be repeated without imposing overly restrictive rules that cause us to miss future good ideas. Errors of omission are also expensive.

Reviewing the Initial Investment Decision and Timeline of Events

We invested in Greentown Management in early 2021 because we viewed it as the "McKinsey" of China's real estate sector. Greentown Management was an asset-light consulting firm that assisted landowners from project inception through completion, adding significant value through its reputable brand. Its comprehensive services included market research, permit applications, financing arrangements, leveraging its brand for premium pricing, and sales and marketing management. Clients simply provided land and capital.

Greentown Management's robust brand allowed it to command premium prices for its customers–homes built under its brand typically sold at least 10% higher than comparable properties. This premium easily covered Greentown's management fees, driving strong demand that outpaced the company's capacity to recruit and train new staff. It was a highly attractive business.

The Chinese real estate market experienced a sharp downturn over the past few years–my timing, as always, was impeccable. Yet, Greentown Management skillfully navigated these challenges by quickly adapting to changing market conditions and benefitted from its asset-light consulting model. From 2020 to 2023, Greentown delivered impressive earnings growth, exceeding its IPO guidance, by delivering a 25% compounded annual growth in earnings per share.

Unfortunately, the good news abruptly ended in 2024. Despite the company's large project pipeline and optimistic updated guidance of 30% compounded annual earnings growth through 2027 (shared in March 2024), in the half-year results ended June 30, 2024, Greentown Management inexplicably reported mid-single-digit growth despite adopting more aggressive accounting related to revenue recognition. The company's strong cash conversion deteriorated, and the founder we built a relationship with departed the company. We could not get clear answers to our questions, and we decided to sell.

Lessons Learned

Looking back, could I have done things differently? Investing in a dominant, founder-led business with strong returns on capital, ample growth prospects, and trading at 12x earnings–especially if we knew in advance that earnings would double in three years–would typically be a no-brainer and still should be!

However, Greentown Management highlighted certain risks that I underestimated. First, real estate construction contracts–especially in a place like China–are inherently complex, which made it difficult for us to monitor material business changes happening beneath the surface. Additionally, governance issues arose from conflicting interests between Greentown Management and its parent company (Greentown China), which led to the founder’s departure and, we assume, led the company to accept projects with less desirable financial characteristics than in the past.

In hindsight, my primary regret is not the decision to invest in Greentown Management but rather not fully accounting for the risks mentioned above and limiting our position size accordingly. Investing usually isn't black and white, and while some risks should be avoided entirely, others can be controlled through portfolio management. I could have done better in this regard.

Conclusion

Uncovering unique opportunities like Greentown Management will define Bonsai Partners in the long run and potentially enable us to deliver excess returns.

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Although I know I will continue to make mistakes, each one makes me a better investor and increases our odds over time.

Team Update

At the end of January, Zi Hao stepped away from investing and Bonsai Partners to build his own company. Although I made a similar choice to take a break from investing when I was his age, it was still bittersweet to see him go. The decision was entirely Zi Hao's.

Zi Hao made a significant impact on me and the partnership, and I'm deeply grateful for our time working together. I'm not currently looking to fill his role.

Concluding Thoughts

As always, thank you for your partnership.
Please don't hesitate to contact me with questions or comments.

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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