

July 30<sup>th</sup>, 2024

Dear Partners,

In May we passed our second anniversary for the fund and are now on our third year. Time flies! I am incredibly honored and grateful that you have trusted me to manage your capital. I repeat that line at the end of every letter because I deeply feel it. Correspondingly I intend to fully deliver on your trust and work as hard as I can to do so.

Frankly, however, it doesn't feel like work. Running a fund is so satisfying because it provides the chance to fully express my personality through our investments. I've written in past letters about how getting to the right level of conviction is so important, and I think conviction is maximized when the way we invest is fully congruent with the specific way that we think. I realized before starting the fund that what excited me most was investing behind amazing products with low valuations, and that remains the case. I love investing in win-win outcomes between businesses and customers, and the thrill of discovery comes from finding such a situation alongside an unusually low, underappreciated multiple. When that happens, and our research verifies that we have a correct understanding of the situation, then it's time to load up!

I recently read some threads on X about how running a fund is so challenging because the manager needs to be simultaneously good at investing, fundraising, managing people, and in general building a business. I disagree with that framing, and as a result I feel a considerably lighter burden. My focus is not to build a great business for myself but to run a high-performing fund; and the performance of a fund will be driven almost entirely by the quality of the investing. As our AUM continues to grow, at some point we will hire a CFO and an analyst, reinvesting the fees that we generate to further support the fund. But the team will always be kept small, and since launch I have structured the fund in such a way that I can maximize as much as possible my time directly spent investing. As we discussed in our initial partners' manual – if that results in a smaller business vs. taking a more traditional approach, then so be it. My goal is simply to deliver to you the best returns I can.

I also wanted to write a bit about the goal of these letters and what I want to communicate each quarter. My goal in general is to share with you my latest thinking on certain investment topics, as well as share some investment writeups so you can better understand the portfolio you own and the pattern of how we think. We may not include an investment writeup every quarter. I prefer not to comment on drivers of recent results because I feel in the short term, much of stock moves are sentiment-driven, and positive performance from a stock in one quarter could easily reverse the next and vice versa (but if you want details, feel free to reach out to me and I'll be happy to walk you through it). I ask that you judge us on a multi-year investment track record.

For most of the period since launch we have been blessed with a steadily rising market, which has flattered our returns as a long-only fund but will not last forever. The true test will come in falling markets – whether we can preserve capital and act rationally under high stress to spring-load our portfolio for future returns. I have a good friend who likes to send me the below poem on a regular basis, which I always find refreshing, and I quote it here:

“The thoughts of others  
Were light and fleeting,  
Of lovers' meeting  
Or luck or fame.  
Mine were of trouble,  
And mine were steady;  
So I was ready  
When trouble came.”

*Counter-positioning to lower prices*

One category of investments that we look for is companies that save their customers money. If you can, through a different/lower-cost business model that's hard for others to copy, save your customers money while providing the same or better service, then that is obviously a great product, and customers will naturally flock to you over time, sometimes even without much marketing.

Wise (formerly TransferWise) is one such example that would have fit perfectly with our investment philosophy but which we unfortunately missed on investing. Wise spends only ~4% of revenues on paid marketing but has nonetheless grown volumes to \$154 billion annually, primarily driven by word of mouth. I first encountered Wise in 2019 when a friend in Poland needed to send me a dividend on a private investment I'd made there, immediately saw the value in the product (as he did when he encountered it in 2014), and should have jumped on the investment when it briefly became cheap in mid-2022. We studied it at the time but alas did not invest.

Other examples abound. The strong performance of Costco and Walmart over decades, the rise of PDD (which we have owned since fund launch) in China e-commerce, GEICO/Progressive, Schwab/IBKR, etc. clearly show how enormous businesses can be built on this very simple concept.

Some people would describe these business models as “scale economies shared,” but I tend to associate that term with larger, more mature companies that have built up scale they can leverage; I think if we're looking in smaller companies to try to find the *next* GEICO or *next* Schwab, what's more interesting is to study the counter-positioning that many of these business models started with (e.g., GEICO direct selling vs. selling through insurance agents, Schwab vs. full service brokers) rather than the scale economies shared that they leveraged *after* the new business model was up and running, which strengthened their value proposition and kept out further copycats. Counter-positioning is where a new business model attacks the market in a different way that incumbents can't copy without large damage to their existing business. PDD is a perfect example of this – its recommendation algorithm focuses primarily on price, whereas Alibaba's focuses on a combination of price/brand/quality/relevancy/ad spend/etc., and it's almost impossible for Alibaba to copy PDD's algorithm without enormous damage to both itself (via its take rates) and its merchants (who rely on the higher prices and brand-building of selling on Alibaba).

Wise is another example, where its business model of 1) setting up direct banking connections rather than relying on others and 2) netting aggregated amounts moving in and out of a country rather than making separate transfers for each transaction fundamentally disrupts the business model of correspondent banking that moves money in multiple expensive hops between banks to its end destination. Once up and running, this business model became very hard for newer entrants to copy because Wise was able to leverage its increasing scale to further drive down costs and spread its network-building investments over a larger customer base. And existing banks can't change their business models to compete – in fact, by moving away from having global networks of local branches and consolidating into their core regions, they are actually moving further away from the Wise model.

So we're always on the lookout for counter-positioned business models like this, businesses that are structurally set up to have a nonstop series of “unfair fights” rather than fair ones. Others might group this into a broader category of “disruption,” but I think that's a term that's become quite vague and drifted from its original Christensen origin, and that disruption without thoughtful counter-positioning brings the risk that incumbents can effectively respond, which is indeed what happened to many startups that attempted to “disrupt” large industries. In order to make for a good investment, disruption needs to 1) be counter-positioned, 2) have a large enough gap vs. status quo for the difference in price/quality to matter

to customers, 3) be able to keep out further entrants copying the new model, and 4) have a good enough economic model such that it's not actually achieving growth by selling a dollar for 80 cents.

The advantage of business models that meet all these criteria is often obvious, which can make pulling the trigger on an investment challenging as these stocks at a minimum will be bid up to a point where they look expensive on current numbers. This was part of our issue with Wise<sup>1</sup>. To build the case for a high-IRR investment result (our requirement), one needs to assume high growth for an extended period, which may well happen but to us felt aggressive and led to lower conviction in our projections. Projecting a long period of high growth of course also leads to risk; the way most investors project growth is to assume a linear deceleration anchored to the current growth rate, but if the current growth rate for whatever reason resets, then that can lead to huge volatility in the out-year revenue estimate and correspondingly in the stock price. In some cases we're willing to make high-growth-for-longer assumptions if we have enormous confidence in the end-state, but that tends to be rare.

Our best hope of making money in a way that aligns with our risk tolerance is in identifying these businesses when they're still small, which means more room for growth into a large market, and often too illiquid for others to invest in, which depresses the current multiple but still leaves room for a re-rating if our thesis plays out. I think we've found such a situation in Cab Payments – a company that saves customers substantial amounts on FX and payments, trades at only 7x FCF, and has the prospect of a long tail of mid-teens or higher annual revenue growth as it continues to build out its customer base and gain wallet share.

### **Cab Payments (CABP LN)**

We missed the opportunity to invest in Wise, but the context gained from studying Wise helped us understand the opportunity in Cab Payments, which is a bit akin to a B2B Wise, enabling low-cost cross-border transfers with a particular focus on Africa. Cab is a regulated UK bank. Rather than servicing individual customers directly, it serves large institutions – international aid organizations (e.g., Red Cross, the UN), fintechs (Wise is a customer), and major banks looking to send money to Africa. Cab's business is not driven by economic conditions in Africa but rather by non-economic flows (e.g., aid, remittances) from developed markets to Africa. (However, Cab can be affected by adverse or favorable central bank interventions in Africa, as we describe later below.)

#### *History*

Cab Payments is the holding company that owns Crown Agents Bank, which has a history dating back to the 18<sup>th</sup> century when the British Crown appointed agents to transfer money from Britain to its colonies; these agents were then consolidated into a single entity, Crown Agents, in 1833, as an arm of the British government that would help colonies arrange loans and invest money. After the independence of the colonies, Crown Agents would stay closely connected with the new central banks and local banking system and would continue to disburse funds from the UK, such as for aid or for pensions, as well as provide technical advice and support.

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<sup>1</sup> Wise had an additional complication, which we love philosophically but presented difficulties in forecasting high EBITDA growth to the distant future – Wise has a “Mission Zero” of eventually lowering transfer fees to near-zero as well as capping its margin, which in practice means regular pricing cuts and, separately, give-backs to customers of interest income gains. This meant even higher volume growth would need to be forecasted to achieve a target level of EBITDA growth, rather than having volume and revenue flow through at a high incremental margin to EBITDA as would naturally happen.

After running into financial difficulties in the 1970s, arising from improper speculative lending, Crown Agents was turned into a public statutory corporation in 1979 and its employees ceased to be civil servants. Crown Agents was then privatized in 1997 and turned into a for-profit company owned by a non-profit foundation, Crown Agents Foundation. The foundation had limited resources and invested very little into the company, including the subsidiary bank. Crown Agents focused on mostly a philanthropic mission of distributing aid.

By 2016, Crown Agents Bank, as part of Crown Agents, was a small lossmaking bank that had vastly outdated IT systems (where payments could only be processed manually and consecutively) and only ~65 employees. However, it had as a hidden asset a network of local banking relationships across Africa and the Caribbean, accumulated as the result of its 200 years of history. The Africa-focused PE firm Helios Investment Partners noticed this hidden asset and had the ingenious idea of turning this network into a FX and payments business focused on transfers to Africa. In 2016, Helios acquired Crown Agents Bank from Crown Agents for ~£40 million.

After it acquired Cab, Helios recruited an experienced management team and invested heavily into the bank's IT, replacing almost all core systems. The IT got to a point where payments could be made fully automatically end to end, APIs integrated directly with customers including the most sophisticated fintechs, and the bank developed a customer-facing FX portal (EMpowerFX) where customers could make transactions. Our understanding from speaking with former employees is that Cab's technology is not as good as that of a modern fintech like Wise, with still some legacy components, but is "good enough" for the type of business that it does and is continuing to improve. Last year, Cab processed £35 billion in FX volumes (nearly £100 million per day), up from £19 billion in 2020.

### *Value proposition*

Helios's insight was that Cab's extensive network of bank accounts ("nostro" accounts that Cab holds) at local banks in frontier markets could be turned into a FX/payments network that enabled direct banking transfers and bypassed the expensive correspondent banking system – analogous to the Wise model. Furthermore, with its multiple banking and FX partners in each country, Cab could play them off against each other to purchase local FX for customers at the best possible rates, beating out even other specialist competitors that might have only 1-2 local partners in that country and enjoying a network effect where value increased with scale (the more volume it had in each country, the more FX partners it could sign up and the better rates it could get for its customers). This banking network would also be very difficult to replicate, due to the fragmentation of the markets and limited volume per market, ever-increasing compliance requirements for large banks that previously had a presence, and general maintenance cost vs. revenue calculations for each bank account maintained that's prohibitive for players with less volume.

All in all, the value proposition of Cab is that, with its one-hop funds transfers, 1) on exotic currencies it can save customers ~100-400 bps versus the multiple-hop correspondent banking system (e.g., a wire to Guinea made by a customer from a regional bank in North Carolina might first go to, say, JP Morgan in New York, then to South Africa, then to Nigeria, before finally reaching its destination in Guinea, with costs and time added at each step), and 2) it can guarantee the transparency and timeliness/immediacy of those payments, whereas transfers made through the correspondent banking system are often subject to unpredictable delays. This is an enormously better value proposition than that of the legacy correspondent banking system, and Cab does it while retaining excellent economics for itself (~low 40s EBITDA margins and ~low 30s pretax FCF margins, which are not out of line with that of similar business lines at competitors StoneX and Corpay).

Cab is also surfing a favorable industry wave, where large banks are retrenching from emerging market banking relationships and ceding share to specialist players. This trend started with banks shedding

ancillary businesses after the financial crisis, accelerated in the 2010s when Standard Chartered and HSBC were hit with multi-billion-dollar fines for improper anti-money laundering/sanctions control checks in their correspondent banking businesses, and is continuing with ongoing announcements (e.g., Standard Chartered selling multiple African subsidiaries to Access Bank of Nigeria, HSBC reviewing its global footprint to focus on Asia, Barclays selling the remainder of its stake in South Africa's Absa and ending its 97-year presence in Africa). As it relates to Cab's markets, these banks have been clear in explaining how the benefit-cost trade-off of dealing in exotic currencies and markets is just not worth it for them. (Not that Cab is skimping on compliance – we hear that Cab has invested heavily in compliance and takes it very seriously, and a common complaint from customers is that they are too risk-averse rather than the other way around.)

Cab estimates that “specialists” (i.e., non-traditional bank participants) including Cab held 15-20% market share of the emerging market cross-border payments market in 2022 and expected that share to increase to 35-40% by 2027 – a ~16% CAGR for all specialists if that scenario plays out. Cab has gained significant share within specialist players over the past several years and will likely continue to do so as it keeps building out its customer base (helped by obtaining a European payments license in April and its expectation of securing a US payments license in 2H24, which will enable it to market to customers directly in those markets vs. waiting for reverse inquiries) and leveraging its strengths in Africa to gain wallet share.

### *Competition*

Cab has only one major competitor, which is StoneX. (Corpay is technically also a competitor, but does not have nearly as strong of a network as Cab or StoneX and in fact is a customer of Cab on certain corridors. Cross-border fintechs like Wise and Thunes are not competitors but actually customers.) StoneX's payments division is part of a larger StoneX conglomerate that does commodity trading on behalf of customers, which led to a natural extension of its payments network to far-flung regions over time.

Geographical differences matter; StoneX's network is stronger in Latin America and Cab's is stronger in Africa. As mentioned earlier, stronger networks lead to better FX pricing, which can be winner-take-most as customers use the player with the best price (though for some corridors, the differences may only be in the single bps). There are no indications that StoneX will unseat Cab in Africa, and likewise it will be a tall order for Cab to make meaningful gains against StoneX in Latin America, though it has some ambitions to do so (which we underwrite sparingly).

In general, our research indicated that StoneX is the legacy player and Cab the share-gaining upstart, rather than the other way around. Cab's technology while not perfect is better than StoneX's, leading to more satisfied customers and deeper integrations. In terms of customer categories, Cab focuses on charities and remittance fintechs, which StoneX is not as focused on and has weaknesses in due to not being a bank. StoneX is strong in relationships with a large number of corporate clients, which is an area where Cab does not compete, both to avoid competing with its large bank customers and also because it is not organizationally set up to do so. One area where they compete most directly is in major market banks (e.g., like a Citibank, where they would offer a white-label service to replace correspondent banking), where StoneX has a head start in building a presence but where there remains a lot of white space and a big medium-term opportunity. Furthermore, one contact mentioned that StoneX already being in a major bank actually makes it easier for Cab to onboard itself along the same lines, and then win business in African corridors from StoneX due to Cab's lower pricing.

As mentioned earlier, Cab has advantages due to being a bank as opposed to a non-bank fintech. Cab being a UK regulated bank engenders more customer trust, and our calls with industry participants were

conclusive on the importance of this point. Cab can hold funds for customers in safeguarded accounts rather than just making payments, and also has a much easier time opening nostro accounts at other banks vs. when fintechs try to do the same. Cab can also use its balance sheet to provide liquidity services, where for example they can float funds to fintech customers to enable instant transactions.

After experimenting with other business models in the early years under Helios ownership, Cab has decided on an admirably clear strategy of being focused on bulk FX payments (average ticket size of >\$100,000) rather than small transactions or payments into last-mile payment systems such as mobile wallets. This is an area where there seems to be a clear need for Cab's service from customers and correspondingly should have a long runway for growth.

### *Post-IPO Developments*

Cab IPO'd on the LSE in July last year with a £850 million valuation, a huge success story from the £40 million Helios initially invested. After the IPO Helios retained a ~45% stake and cut back its influence over the company, keeping just one active board seat.

Unfortunately, right from the start after its IPO, Cab's liquidity was poor at only \$1-2 million per day, which seriously limited investor interest. Management was also over-promotional, telling investors to expect 35-40% annual revenue growth (!) with 55-60% medium-term EBITDA margins. Guidance philosophy and expectations management was also poor, with the company guiding to a major ramp in Q4 results in order to meet annual revenue guidance. When that ramp did not appear, partly as a result of unexpected central bank interventions in the Central African Franc (XAF) and West African Franc (XOF) currency blocs that had the effect of squeezing Cab's volumes and take rates in those currencies and necessitating a 50% cut in Q4 revenue guidance, the bottom fell out from the stock, with a decline of 70% in one day in October 2023 alongside a total collapse in investor confidence. To the outside observer it might even have been reasonable to suspect some kind of deception may have been pulled, with the British press running articles criticizing everything from the disclosures in the IPO prospectus down to Cab's underwriters and lawyers, and the situation turned into a story with which to criticize the sorry state of the entire London stock market (which may be a valid criticism – see Kaspi having its daily trading volume 10x and its stock rise +40% within two months of moving its listing from London to New York – but is probably a separate topic).

From the low, Cab slowly built back investor confidence through extensive 1-on-1 conversations explaining what had happened and by ultimately beating the lowered Q4 revenue guide by 23%. Combined with delivering in April on its promise of obtaining a European payments license that would allow it to directly sell to European customers, Cab stock at a recent peak in May reached 166p, rising 248% from the lows but still sitting 50% below the IPO offering price. Cab's CEO who led the disastrous offering was replaced with an outside executive who has 15+ years of CFO experience at other UK banks (as opposed to the non-bank fintech background of the previous CEO), and his comments suggest that he will take a more measured and disciplined approach to the business as well as investor communication. The new CEO officially took on his position on June 13<sup>th</sup>.

Unfortunately, the October 2023 update wasn't the final shoe to drop. Last week, Cab announced preliminary 1H24 results that were much weaker than what the market expected, leading to a ~12% cut vs. the prior soft annual revenue guide. The resulting 14% intra-day stock drop combined with extended weakness leading into the trading update means that Cab stock is again down 47% from its recent May peak.

1H24 results were weaker than expected because 1) conditions in the currencies where the central bank had intervened in 2023 to limit foreign players, i.e. the Nigerian Naira/Central African Franc/West

African Franc, deteriorated further rather than stabilizing as the company had expected; and 2) charity organizations, which represent ~30% of Cab's revenues, cut back on aid flows in the relevant corridors due to this year's elections and political changes.

In the context of all these developments, a good question would be whether this is too volatile of a business to be worth investing in at all, with conditions driven by unpredictable interventions by distant central banks and with management seemingly unable to forecast its own business. We've frequently heard other market participants express a view that this is a good business but one that "should not be public."

Our philosophy of focusing first on the product leads us to take a different view.

- Our research was conclusive that Cab's network is unique and irreplicable, its business saves customers money and in doing so would continue to attract more customers, and through the nature of its business model Cab would generate high margins for itself. This is the core aspect we focus on, and recent developments have not shaken our conviction in this core value proposition.
- We're willing to take on volatility if we are being compensated to do so. Cab trades at 7x our estimate of 2024 FCF (6x 2025), for a business that should compound FCF in the high teens due to revenue growth and operating leverage. Our base case IRR for Cab approaches 40%, the highest of any stock in our coverage, though of course with unusually high volatility.
- Cab's business is unlevered with no financial debt and in fact runs with substantial excess capital. In banking terms, Cab has a common equity tier 1 capital ratio of 26%, far higher than the mid-teens CET1 ratio of other UK banks. In theory it could pay out a large dividend or buy back a substantial part of its current market cap, but management has made clear that it would not do so in order to continue building up its financial strength and leverage its balance sheet to drive further competitive advantages vs. non-banks like StoneX and add additional revenue.
- We believe the key sources of revenue volatility, namely Naira/Central African Franc/West African Franc, are near-fully out of revenue guidance expectations, leaving only upside if conditions in those currencies recover (which we believe is actually reasonably likely, as these central bank interventions have the effect of squeezing dollar liquidity over the medium term and tend to reverse for that reason). The rest of Cab's business by currency corridor is much more diversified.
- It's clear that prior management has done a horrible job of expectations management, though negative macro conditions beyond their control have not helped. We have hope that the new CEO, Neeraj Kapur, will take a very different approach in this regard, and as a longtime former CFO he will be closer to the numbers than the prior CEO was (the prior CEO was known to be hands-off).

Cab is now a \$290 million market cap company that trades ~\$1-1.5 million per day, far too small for most funds to invest in. Even for smaller funds, this is a difficult investment to make because it requires a lot of work to understand but simultaneously falls into a "one-off" bucket with limited synergies with other investments, making for a difficult return-on-time calculation. But for us, "one-off" investments into illiquid companies with great products are our specialty. We are guided by our curiosity as well as our intuition when we feel there's great value, and when both are present we are willing to invest as much time as is needed – whether it's here or for example in Georgia, a small economy where effectively the only investable companies are the two banks. When setting up the fund we decided not to short specifically so we could allocate all our time to researching great longs. For us that has proved to be a great decision. We scour the world looking for great companies, thinking with one brain instead of two (long and short), and when we find what might be a great opportunity, we jump on it and bring all our research effort to bear.

## Conclusion

At one point intra-quarter we reached a high level of capital deployment, but as some positions worked out and we trimmed or sold, and others we changed our minds on as the facts changed, once again we are sitting on a high cash balance. As always, we are working hard on finding investments so as to deploy as much cash as we can, but will not force it if there are not good enough candidates in which to do so.

As always, I am immensely grateful for the opportunity to manage our capital and am hard at work trying to compound it at the highest rate that I can.

Yours,  
Tim Liu