December 17, 2024

Dear Partners,

Our fund is named "Meditation Capital" because we intend to invest in a meditative way – to always be contemplative and deliberate in our decision-making, to keep our head regardless of what is happening around us. And a lot indeed is happening around us! Our task is to navigate whatever comes with a calm mind.

We have a clear goal for the fund (as laid out in our partners' manual: "to compound our money at high rates of return while making my best efforts to continually maintain safety of principal") as well as a few key principles:

- We always think from the long-term first. Something that's not sustainable for the long term we don't invest in (speculate on) in the short term, even if it would likely make us money; and this focus on the long-term is what leads us to only look at companies with great products.
- We focus heavily on valuation, as, holding constant our view of a given company's growth and quality prospects, valuation/price on entry is *the* key input into underwriteable IRRs that we use for our decision-making. Adjusting appropriately for the quality of business (and understanding that for bad businesses there may be no floor despite optically cheap multiples), valuation is also a key source of downside protection.
- We aim to gain conviction, and thus holding power, by underwriting investment cases (with price targets composed of achievable future cash flows times conservative future multiples) that will work over the medium term almost regardless of what happens in the economy or markets in the interim. We assume conservative exit multiples because we don't want to rely on the kindness of the market to give us a great exit multiple – an assumption that would cause our conviction to suddenly become impaired if the market takes a downturn. And in general we don't make bets that other people will take us out at valuations, driven by shorter-term dynamics, that are not reasonable over the longer term.

The latter two principles constrain the multiple we're willing to pay, which in this environment significantly constrains our opportunity set vs. the broader universe of companies with great products that we admire.

I think it's not fully appreciated, or has become forgotten or willfully ignored, how significantly high multiples damage medium/long-term IRRs, under most conditions (except for one where ebullient sentiment persists indefinitely and we enter a new normal that reveals how mispriced equities have been versus long-term bonds over almost all the prior periods). This point is immediately obvious to private equity investors I speak to, investors who put a lot of thought into exit multiple for consequential investments that cannot be easily reversed; but can easily be forgotten in the public markets as investors ride waves of multiple expansion/momentum and blend together elements of serious investment and speculation.

Take software as an example – a sector that we've invested heavily in in the past and still have some investments in today. Take a company that trades at 14x NTM revenue today (which would put it just #9 in the top 10 highest multiple software stocks) when revenue growth is 25%. For an exit in four years, when revenue growth slows down to mid-high teens, the company becomes more mature as a percentage of its TAM, and competition arguably catches up to a greater degree – we would be uncomfortable underwriting anything more than an 8x revenue multiple. From 14x to 8x is -43%, or -13% per year, a number that eats up most of the anticipated return that would have come from ~20% compounded revenue growth during that period (before accounting for meaningful annual share count dilution from stock-based compensation as well as some FCF generated).

We usually assume we exit software investments at 5-6x revenue (driven by implicit assumptions for long-term margin potential and multiples of normalized profit), maybe 7-8x for exceptional companies, which makes it very hard for us to own any software company trading for over 10x NTM revenue while still forecasting an IRR that meets our investment bar, especially as revenue growth has slowed substantially for the whole sector. The same "major IRR headwind from multiple" logic can be applied to many other investments in other sectors in this market, including some companies we used to own.

However, it has become very unpopular to think about absolute valuation multiples in this market. Especially in more liquid, pod-dominated sectors such as software and internet, certain stocks move up regardless of starting valuation because investors chase estimate revisions driven by business momentum (what pods look for, and quantitatively has worked very well in recent periods). Then for those stocks a fundamental thesis is often back-justified, based on Y+1 or Y+2 revenues/earnings, usually involving substantial 1-2 year growth and a flat or expanding multiple. If that is your default valuation framework, 1-2 year growth plus flat/expanding multiple as the business is "accelerating", then you can make a compelling investment case for a very large number of stocks! One problem is that these investment cases are fragile, at risk of sudden collapse if a hiccup occurs at the company or market-wide multiples decrease. Longer term there are serious consequences from a high multiple inevitably compressing (except in exceptional cases including where high growth outruns it), but these are mostly ignored as something that will occur outside the investor's time horizon, outweighed by the positive prospects of more short-term gains ahead.

Applied more broadly on a market level, I think it is sometimes lost on investors that rapid price increases mostly represent not new value being created but existing future value being pulled forward at an increasing rate. A 13% increase in NTM P/E multiple from 20.4x to 23.0x on top of a 12% increase in NTM EPS estimates feels great (the formula, plus dividends, for a 29% increase in the S&P 500 this year), but another 10-20% increase in multiple would move valuations far out of historical range, and 12-13% annual increases in S&P earnings (which are being forecast for 2025 and 2026) far exceed the underlying growth of the economy, even accounting for a higher quality mix of businesses represented in the S&P. A sharp rally (which could very well continue driven by strong economic conditions plus further easing) is cheered in the moment but should be viewed with concern by long-term asset owners like ourselves who 1) will invest more assets in the future that we want good returns on and 2) do not want to see hard-won gains in capital reverse, with all the associated consequences. We maintain our focus on protecting capital in this environment and, as we always do, continually shift our investments to ones with still-high IRRs and strong downside protection.

As we've written before, we don't invest based on macro forecasts, nor do we even attempt to make macro forecasts. We invest based on an unceasing bottom-up search for opportunities, and every once in a while we pick our head up to try to understand why we're seeing so few or so many opportunities. Our bottom-up view of the opportunity set drives our portfolio allocation, e.g., our mix of US vs. international stocks vs. cash (when we don't find enough opportunities that meet our bar). Our resulting portfolio mix is sometimes quite unique; we picked the S&P 500 as our benchmark not because our portfolio remotely matches the S&P in composition but because we think it represents our partners' best and most likely opportunity cost. We will not outperform in all market environments, but we aim to significantly beat it over time.

Our investment principles aren't universal principles, and there are many ways of making money in the market. Despite our commentary above we don't begrudge those other ways, which in practice to do correctly involves substantial sophistication and skill. Nor do we seek to excuse ourselves from the task of finding great investments regardless of the market environment – and our ability to search globally and in less liquid stocks helps greatly in that regard. We are focused on playing our own game well.

Our principles are what we believe and what works for us, adapted to my own personality and way of thinking; and by applying them consistently, deliberately, and dare I say, meditatively, I have strong belief that we will achieve our goal and generate high long-term returns while protecting capital.

Recent travel

A few weeks ago I made a trip to Istanbul, Yerevan, and Tbilisi, to visit our investments in Kaspi (which acquired Turkey's Hepsiburada), Bank of Georgia (which acquired Armenia's Ameriabank), and TBC Bank. We previously wrote up Kaspi in our Q4 2023 letter and Bank of Georgia in our Q2 2023 letter.

Some of our investments in the broader Caucasus/Central Asia region are putting up incredible numbers while trading for Temu prices:

- Halyk Bank is the #1 bank in Kazakhstan and trades for 2.8x earnings / 0.9x book value. In Q3, Halyk Bank reported a 38% ROE (we assume lower on a normalized basis). The company just paid a second dividend for the year of $0.75 per share, which on top of a $2.25 dividend paid in June means we received $3 in dividends (and there is no dividend withholding tax in Kazakhstan) on a stock that traded at $15 at the start of the year (and the year prior we first bought Halyk at $13.4 and received a $2.25 dividend a few weeks later). Next year we anticipate at least a $3.20 dividend (this is mostly locked in, as the payout next year will be calculated as a percentage of this year's earnings) on top of mid-teens local currency earnings growth. Halyk has performed well through many economic cycles and is conservatively capitalized with a 19% CET1 ratio.
- In Q3, Bank of Georgia reported a 37% ROE in Georgia (though this had a benefit from abnormally low cost of risk; normalized ROE for the quarter was in the low 30s). Since our initial purchase in June 2023, the total return in Bank of Georgia stock with dividends reinvested has been 76%, yet the multiple on book value today is only marginally higher (1.1x vs. 1.0x); the growth has almost entirely come from strong growth, dividends/buybacks, and an extremely accretive acquisition of Ameriabank, the #1 bank in Armenia, that immediately boosted book value per share by 20%. Bank of Georgia has an incredible superapp, far better than what we have from the likes of BofA and Chase in the US, and Bank of Georgia's latest NPS was 67, up from 38 at the start of current CEO Archil Gachechiladze's tenure in 2019. Archil calls NPS "a part of our DNA and religion," which like with Kaspi is music to our ears as product-focused investors. After Georgia and Armenia, Bank of Georgia is also now on its hunt for its 3rd market. Georgia more recently is experiencing some political turmoil, which we discuss further below.
- TBC Bank is tied with Bank of Georgia in being the #1-2 bank in Georgia. TBC also has an Uzbekistan digital bank that is expected to generate 11% of total group profit in 2025 but has the potential to more than 3x its 2025 profit by 2028 – an opportunity that its stock, which trades at barely above book value (1.1x), does not price in. Uzbekistan is a former longtime closed economy that only liberalized and opened to foreign investment under a new leader in 2017, which has since spurred a major wave of growth in a large, 34 million population with only $3,000 GDP per capita (vs. $14,500 in neighboring Kazakhstan). In Q3, TBC's Uzbekistan business reported 99% y/y growth in loans while generating a 28% ROE (on its way to 40%+ per management's targets). Under the leadership of former longtime Tinkoff CEO Oliver Hughes (an incredible management pickup for TBC) and former Kaspi executive Nika Kurdiani, TBC Uzbekistan in just the past few months has rolled out a series of exciting products, ranging from a debit card modeled off Tinkoff Black/Kaspi Gold to a revolving credit card, fully along the timeline they communicated to investors at the start of the year. Kaspi failing to acquire local credit card network Humo and focusing instead on Turkey seems to leave the runway clear for TBC Uz's continued strong growth.
- Kaspi continues to perform strongly and is headed toward 25% earnings growth this year, with another ~21% for next year (before incorporating Hepsiburada), which puts the multiple on 2025

earnings at just 8x. Kaspi is now fully focused on turning around its acquired business in Turkey; our visit and broader research revealed both major challenges (the market leader in ecommerce, Trendyol, is a strong company with a large lead) but also substantial low-hanging fruit with regards to product, technology, financial services integration, culture, etc. that we expect Kaspi to firmly grasp. During the quarter, Kaspi was the subject of an entirely false but headline-grabbing short report, which we strongly responded to online and which was later repudiated by Kazakhstan's financial regulator; the report is a likely contributor to an overhang on shares and a hurdle for non-specialist investors to get through, but we expect the impact to fade over time as Kaspi continues to develop its business and post strong results.

Georgia

This trip was our second visit to Georgia; this time coincided with a major wave of protests, and I ended up joining a Georgian friend to witness one night of protests on Rustaveli Avenue. While I was there, very differently to how it was portrayed in media and on X at the time, life in Tbilisi continued as normal, and the evening protests were peaceful; most protestors returned home in the early evening and a small hardcore group remained in the early morning to battle police that tried to clear out the street for morning traffic, the results of which generated the controversial scenes that were posted on X. This pattern repeated daily. The style of protesting was civilized, with protestors having no intention to destroy or paralyze their own city; businesses even at the epicenter of the nightly protests were left entirely untouched.

We will spare you the details of Georgian politics, which we have spent a great deal of time studying. The short version of events is that in response to an EU parliament declaration that recent Georgian elections were not fair and that Georgia should hold new elections, Georgia's prime minister announced that Georgia will pause accession talks to the EU until 2028 (notwithstanding the fact that the talks were already declared mostly dead from the EU side). This caused a major negative reaction from Georgia's very pro-EU populace and has resulted in major protests.

We empathize with the pro-European aspirations of the Georgian people, who we greatly admire. At the same time, we do not view the ruling Georgian Dream party as pro-Russia or controlled by Russia, as is claimed by some; the best framing seems to be that they are 1) motivated to remain in power which drives certain authoritarian actions and 2) simply not as anti-Russia as some would want them to be, a position that seems motivated by understandable pragmatism, with Russia as their neighbor and with Georgia having received little support from the West in its previous conflict with Russia. Georgian Dream has a firm grip on the levers of power, and we view a push for new elections or regime change as very unlikely to succeed; but if it does, after initial turmoil a more pro-European and less authoritarian government would not be a bad long-term outcome either. What we always found interesting and attractive about Georgia is that all major parties are very pro-free market, with little difference in economic policy.

Our on-the-ground visit as these events were developing was very helpful, as we were able to get the immediate reactions from the bank management teams, national bank, and other contacts as events occurred. We took the opportunity from a minimal negative move in the bank stocks to meaningfully de-risk our position while we observe what unfolds. While we think the banks will be fine in almost all scenarios, this was driven by our desire to protect capital from left tail events, which are still very low but have increased in probability. We worried specifically about 1) perception risk if protests escalate further, 2) volatility in the lari if lari holders convert more currency to dollar beyond the national bank's ability to offset, and 3) possible sanctions on individuals in Georgian Dream from the outgoing US administration, which if kept to individuals will not affect the banks but which have a very small chance of extending to the broader economy in Georgia (this is not on the table at all and is entirely our own speculation about tail scenarios; the US and EU have been clear about wanting to support rather than harm the Georgian people). Since our decision to de-risk, the lari has remained stable, and there are already some signs that protests are fading from peak levels. President Trump's inauguration on January 20th will also bring in a new administration that is poised to take a more pragmatic and less ideological approach to foreign policy, lowering the risk of further sanctions made for mostly ideological reasons (why does deciding to pause EU accession talks for four years deserve sanctions? Once you start the EU process, "now youse can't leave"?). At some point we will likely look to again increase our position.

Longer term, we are very positive on Bank of Georgia and TBC Bank. We wrote about the setup in our Q2 2023 letter: two banks of roughly equal size comprising 80% of the market, both excellently run with very good products, in a fast-growing economy; and each with an exciting story outside of Georgia (Armenia and other future markets for Bank of Georgia, Uzbekistan and other future markets for TBC Bank). In particular we love Archil at Bank of Georgia and the NPS/product culture turnaround he has driven during his tenure there, with associated gains in market share across multiple categories like retail deposits and payments acquiring. Archil's ambition is for Bank of Georgia, a UK plc, to join the FTSE 100, which they are only a double in market cap away from doing so. It's not as far-fetched as it sounds, given that the current P/E is only 3.5x; some potential multiple expansion plus continued earnings growth would eventually get them there.

Georgia's economy is extremely well managed, with high-single digit GDP growth, low-single digit inflation, 37% debt to GDP (vs. 123% in the US), -2.5% government deficit to GDP (vs. the -6.4% we have in the US), and a currency that has depreciated at an average annual CAGR of just 1% vs. the dollar since 2003. Georgia also has a high degree of human capital development and for whatever reason seems to produce great business leaders (one explanation we heard is that it's because Georgia has no natural resources – doing business is the only way to succeed). The CEO of Kaspi, Mikhail Lomtadze, is Georgian, as is also Kaspi's CFO and some other members of its founding team.

While we're not counting on it, if President Trump does manage to somehow bring an end to the war in Ukraine, that would likely cause a major boost to the multiples of our Kazakh and Georgian positions. Regional multiples have taken a severe and long-lasting hit ever since the start of Russia's invasion of Ukraine. We always viewed the risk of war or sanctions extending to Kazakhstan or Georgia as extremely low and mispriced, and consequently through our ownership we have benefited from strong business growth and capital return, but not so much in terms of multiple expansion; other investors so far do not agree and will likely continue to give these assets some degree of discount as long as the war lasts (and as an example, the Kaspi short report mentioned earlier basically consisted of saying "Russia" and "sanctions" a lot of times, and which despite being entirely illogical and false was surprisingly effective in hitting the stock price, a reflection of the current investor mood about anything even possibly adjacent to Russia).

Conclusion

I anticipate continued travel in 2025 to visit our portfolio companies and soak in local environments. I find it a huge shift in conversation when management teams are not in "conference mode" and we can discuss topics in their home environment over both meetings and meals. It also helps concentrate the mind to spend a few days thinking nonstop about one topic – something we can theoretically do at home but in practice is hard to implement.

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