

October 25, 2026

Dear Partners,

This has been a good period for our software investments. Braze this week was acquired by Salesforce, Atlassian abruptly rerated from application software loser to infrastructure-like winner, Dynatrace caught an observability bid, and Workiva received some degree of rerating from unreasonably low levels. Klaviyo is now the cheapest software stock we own, with its multiple at less than half of start-of-year levels, and we write about it later in this letter.

Positioning-wise, we fully exited Atlassian and we treat Braze as near-cash (Salesforce has no discretionary out in the merger agreement and we believe an antitrust issue is unlikely due to the fragmentation of the market). Combined with some other trims across the portfolio, this again leaves us with a higher-than-normal cash position, which we are working hard to deploy.

We rarely reflect on successes (our minds usually move straight to the next idea), but we feel this recent experience vindicates our relatively simple investment philosophy: looking for companies with amazing products, high growth, and low valuations. Low valuation drives our repositioning in search of opportunity. High growth means we can wait for compounding rather than depending on multiple expansion given by the kindness of others (many asked us when software would rerate given the severity of the overhang, to which our response was, “who cares?” In practice though, oftentimes the opportunity gets discovered by others and our return is pulled forward). And amazing product drives our conviction in terminal value and conviction in the investment, even in the face of adversity. We remain steadfast in our belief that great products are rare, require enormous effort to create, and that the unusual management teams who created those great products will creatively adapt new technologies like AI to make their products even better rather than, improbably, suddenly stop innovating and get disrupted. Finding amazing products that add value to customers and to society is what excites us, and we continue on our search.

AI vs. AI capex

This is an unusual environment. The entire market is driven by the vicissitudes of the “AI trade.” We are big users and fans of AI (at this point our workflow involves talking with Claude constantly) and would of course love to invest in AI. But what is available in public markets (as opposed to private markets, where exciting things are happening albeit at extreme valuations) is not really an “AI trade” but an “AI capex trade.” We view the difference with great caution.

For our investment philosophy (adding our usual caveat that it’s not prescriptive – there are many ways to make money in the market), a great “AI trade” (or, more befitting our investment style, call it an “AI investment”) would have the following characteristics:

- Benefits from the use of AI on a recurring basis, to generate recurring revenues and profits;
- Benefits from innovation and competition which drive down the cost of AI per unit (case in point, DeepSeek recently released some more astounding cost optimizations); and benefits even more so if AI capex happens to go into oversupply and the cost of tokens falls further;
- Available for purchase at a reasonable valuation, on reasonable forecasts of future revenues and profits that do not require AI capabilities to compound to levels well beyond what we see today (which could well happen, and we hope it does, but our intense focus on preventing capital loss requires us to bet only on what we have very high confidence in).

We believe some of our investments have these characteristics, though it’s still early: Nubank is using AI to dramatically improve underwriting models, Klaviyo is using AI to increase personalization of messages

and enable customers to automate email strategy, Workiva is steadily rolling out more agents to do work in financial reporting, etc.

The “AI capex trade” does not meet our criteria:

- The revenue is cyclical and volatile. As we’ve described in past letters, since growth of AI capex is a second derivative of underlying AI usage, for AI capex stocks to do well, underlying AI usage must be continuously accelerating in terms of net additions rather than just growing, and the implied AI revenue required from out-year capex projections is now very large (multiple trillions). This seems a tough bet for us to make because the road to broad adoption may not smoothly match forecasts¹ and will likely take some twists and turns. An AI capex thesis depends on both path and end-state, not just end-state. We have huge respect for the investors who saw these trends early, but now the hour feels late.
- The AI capex trade depends on strong margins cascading throughout the stack below, which incentivizes and funds further buildout. Margins depend on supply and demand². We truly do not know what margins look like in 2028 when accelerating supply is added in 2027 (>40 GW) and 2028 (>60 GW). Pointing to current compute shortage, rental prices, and token prices when deliveries are ~23 GW in 2026 is to us simply not a compelling argument as to what compute supply/demand looks like after another 100 GW by 2028 (and >70 GW per year thereafter – remember, capex needs to constantly grow). The *urgent* and near-speculative nature of the AI capex buildout (see Zuckerberg’s recent comments on Cheeky Pint about deciding at the end of 2025 to spend \$100-200 billion before knowing whether it’ll work; or Elon suddenly declaring SpaceX will try to add 10-20 GW in 2027, representing \$500 billion – \$1 trillion ARR) also feels unusual to us. There is a lot of focus by investors on AI capex supply driving revenue while end-user demand is not precisely countable and thus almost assumed (driven by model progress and diffusion). We also suspect, per our last letter, that agentic coding was a huge accelerant to AI revenues in 2026, a perfect use case for AI, and while coding will continue to grow the next big token-consuming use case of similar magnitude has yet to be clearly found and if not quickly found may result in an air pocket (and no, we don’t think Muse/consumer agents are that use case, when compared to the “always-on” token intensity of agentic coding).
- We worry that AI capex is not a clean bet on AI demand but embeds a hidden pair trade: long compute demand (betting on AI innovation), short compute efficiency optimization (betting against AI innovation). Last quarter we laid out our view that AI supply/demand should be looked at in terms of the number of useful tokens, not just GW; supply grows multiplicatively through 1) growing AI GW buildout times 2) significant chip improvements (tokens/second/watt) times 3) model-side algorithmic efficiency. With the help of AI, dramatic innovation on the second (e.g., OpenAI’s

¹ Sam Altman, Aug 23: “I think I was wrong about a few things, but one of them, in terms of the speed, is the economy just has so much inertia. People keep doing the same things they’re doing. They keep buying from the same company. They keep sort of wanting to use their tools in the same way. I think this is actually a positive in many ways, and it’s going to make this big transition in front of us go smoother and slower... But I think it means we’ve all been too ambitious on timelines, even with this incredible technology. I think AI is one of the most incredible technologies humanity has ever invented. Society and the economy will adapt more slowly.”

² Ken Griffin, Oct 20: “And in particular, I don’t want to be doom and gloom, but GPUs, like airlines, have a very low marginal cost to run. The incremental seat on an airline that’s not full, if you can sell that ticket for \$20, you’re making money in that seat. And that’s one of the reasons that the airline industry is such a nightmare, is because the moment you have overcapacity, pricing goes into free fall. We saw this actually with the telecom build-out back in 2000. We built more fiber than we had demand for, and the price of telecommunications just went straight down. If we reach a point where the provisioning of GPUs exceeds demand for GPUs, marginal pricing will actually go into free fall. And that really upends all the investment assumptions that people are working with today.” Ken’s comments were about GPU rental, but we would argue a similar logic applies to Anthropic/OpenAI token pricing; the labs have contracted for fixed-price, take-or-pay capacity, there could be up to 4-5 strong closed labs plus an open-weight ecosystem, and in a compute glut there would be a lot of pressure to monetize perishable capacity.

Jalapeño chip) and third legs (DeepSeek and Kimi on inference speed and memory usage, Meta planning to improve the cost efficiency of Muse by more than 10x in the next year, etc.) keeps coming. Maybe “Jevons paradox” is the right answer in the long term, but that doesn’t address timing (Jevons was an observation around coal usage and steam engine efficiency over decades and makes no promises for how fast demand shows up year-to-year; for the 90s fiber buildout Jevons was ultimately right over decades but fiber owners in the moment still lost). For the AI capex trade any temporary air pocket in supply vs. demand can be brutal.

- The biggest disconnect for us is that markets seem to be pricing in an “enormous growth” case (implying trillions in lab ARR) as a base case. And to be bullish on AI capex stocks, one has to be even more bullish than consensus, on both the short and long term. Maybe that happens (and again, we hope it does, as it means enormous value is being created that benefits all of us), but it goes against our nature to use that as a base case. We are conservative by nature, and we want to have huge confidence in what we need to believe. This is not prescriptive and has pros and cons. The con is that we have missed, and will likely continue to miss, further massive breakthroughs in AI. The pro is that we hate losing money and are laser-focused on capital preservation in all market scenarios. We will make our money in other investments that feel lower risk. We are eager to invest in AI, but on our terms and in AI products, not AI capex.

Klaviyo

We mentioned Klaviyo briefly in our last letter. Klaviyo is a very similar business to Braze, just attacking a different customer size (Klaviyo is SMB to mid-market, Braze is much higher upmarket in enterprise) and a more specialized sector (Klaviyo is focused on Shopify ecommerce merchants, Braze is for app-centric direct-to-consumer companies across sectors).

Klaviyo is the dominant retention marketing platform for Shopify ecommerce brands (tracking indicates >50% market share in Shopify Plus brands). Retention marketing is the other side of the coin from acquisition marketing, e.g., spending to acquire customers on Facebook or Instagram. Retention marketing involves sending emails and texts to existing customers to try to get them to purchase again. Both sides are needed for a successful business, but retention marketing is near-free and thus far higher ROI than acquisition marketing. Retention marketing is also a key input in improving the ROI of acquisition marketing, by using automated and targeted engagement flows to further convert customers who clicked an ad (very expensive) and thus expressed interest but didn’t initially purchase (in other words, for the same ad dollar spend, a company with a better retention marketing program can meaningfully lower its cost per acquired customer). For many of Klaviyo’s customers, retention marketing through Klaviyo drives ~30% of their sales, making Klaviyo a key revenue contributor rather than just a cost line.

Klaviyo has an amazing product, which in part explains its high market share (the other part is its partnership and best-in-class integration with Shopify and the Shopify ecosystem). Klaviyo customers and agency partners (retention marketing agencies that manage email strategy for their ecommerce clients) love Klaviyo. We’ve done 35 calls this year with people in the Klaviyo ecosystem (customers/partners/former employees), and the feedback is near-unanimous on product (with a few complaints about pricing, but that’s to be expected given Klaviyo is priced at a >60% premium to competitors, yet customers rarely switch and its flow share of incremental Shopify growth is high – a signal its moat is battle-tested against cheaper competitors, a factor relevant to the AI risk discussion below). What also surprised us was how several of the agency partners we spoke to said they personally owned Klaviyo stock. This is something we’ve rarely seen before with other investments – that partners, who can see all the email alternatives out in the market, believed in Klaviyo so strongly that they bought stock in the open market after Klaviyo went public in 2023.

We believe Klaviyo is well-insulated from AI risk. In our last letter we laid out our framework for AI risk, focused around analyzing 1) risk from customer self-build, 2) risk from new competitors, and 3) whether the nature of the job changes completely (with consumer agents, does email get read by agents instead of humans? Will businesses still invest in email?).

Starting with customer self-build, we think this is a category where it is unrealistic and a vendor is required:

- The hardest part to self-build with quality, and the most important for generating revenue, is email deliverability – whether emails land in the main inbox or in promotions or in spam. This is made harder because the bar is not fixed but constantly rises – email deliverability is adversarial against recipient systems that try to filter users’ inboxes and regularly impose new rules or requirements. Klaviyo specializes in this domain, the customer does not; and the potential revenue impact from a decline in email deliverability can outweigh the Klaviyo fee by an order of magnitude. When we talk with knowledgeable people in the space, it’s clear that this alone kills the value-add of a customer self-build, especially when there are many email providers out in the market, all priced ~40% lower than Klaviyo. The realistic alternative to Klaviyo is another vendor, not an in-house build.
- Klaviyo functions as a system of record for its customers’ CRM data and messaging workflows. Data from not only Shopify but also numerous connected apps (reviews, loyalty, subscription, support, pop-ups, unidentified visitor capture, etc. – the average Shopify merchant with a reasonable amount of revenue has 10+ apps) flows into Klaviyo for context and actioning for messages. The size of the average customer is also relevant here; Klaviyo-sized brands usually have small, non-technical email teams, and this would be a heavy lift to not only build the whole core platform and switch but also self-build and maintain integrations to every connected app.
- Rising Claude/Codex use is not a risk (a core platform to manage data and execute sends is still required, as per above) but rather a major benefit to the value and ease of use users get out of Klaviyo. Klaviyo has fully embraced MCP and headless, and we’ve now spoken with many partners who manage most of their Klaviyo work in Claude. Data analysis, campaign planning, email design, etc. can all be done in Claude and pushed into Klaviyo for execution.
- In addition to email, SMS/WhatsApp is rising as a key channel for brands to reach customers. Due to regulatory issues, SMS requires a vendor. Furthermore, there are large benefits to sending email and SMS through the same vendor, so that marketing campaigns can be more closely coordinated. This is also why Klaviyo’s SMS product has been gaining in attach rate (the latest disclosed number is 30% of SMB and above customers), taking share from SMS-focused vendors like Postscript and Attentive.

This then leaves competitor risk as the more realistic AI risk for Klaviyo. Perhaps, due to AI, 1) existing competitors will make their email products a lot better and close the gap with Klaviyo; 2) many new competitors will pop up and drive a price war; or 3) Shopify will make its own email product a lot better and compete harder with Klaviyo.

As mentioned earlier, Klaviyo’s moat is battle-tested against cheaper competitors. Klaviyo’s most direct competitor is probably Omnisend, founded in 2014; Omnisend is priced ~40% cheaper on a per-email basis but has only 5% of Klaviyo’s ARR (~\$70 million vs. \$1.5 billion). Sendlane effectively failed and sold to a rollup, Yotpo which was successful in reviews and loyalty and reached unicorn status tried to extend into email but shut it down after two years, MailChimp continues to lose share, etc. Clearly Klaviyo’s moat is deeper than it appears on the surface (“software for sending email”). We believe the key elements of the moat are:

- Email deliverability – Klaviyo is better at it than its competitors. It has its own email sending infrastructure (shifting its volume off Twilio’s SendGrid), dedicated IPs for larger customers, easier one-click fixes for customer deliverability issues, a bigger team monitoring signals in real time for

issues and abuse, etc. Customers who switch tend to report worse deliverability, and deliverability is one of the main reasons why churned customers boomerang back.

- Best-in-class integrations not only with Shopify but with all relevant Shopify apps (i.e., the average 10+ apps per customer we discussed earlier). Competitors tend to integrate worse with Shopify and may be missing integrations with certain apps entirely.
- Best ease of use, the most features; just a great product. Users love using Klaviyo. This is the part that competitors could conceivably catch up on, but in practice we have our doubts – making a product great is not just a matter of using AI to add more features. Klaviyo is also shipping quickly to incorporate AI to make its own product better, which continually raises the bar.
- Huge mindshare in the Shopify ecosystem, which forms a distribution moat. Klaviyo is effectively a default and competitors complain that most deals never go to RFP. Unlike other SMB software which has been crushed by Google search changes, Klaviyo does not depend on paid search, and discloses that its advertising expense is only 4% of revenue. Klaviyo does have a large sales force that targets larger accounts but its sales and marketing efficiency (new revenue generated per dollar of S&M expense) is very high, which bodes well for end-state margins.
- Agency partner ecosystem – we’ve heard estimates that ~40% of Klaviyo customers use an outside agency to manage their email strategy. These agency partners influence their customers toward Klaviyo – they are most familiar with Klaviyo, do their work quicker and more effectively in Klaviyo, and are heavily incentivized by Klaviyo in terms of revenue share – a setup that reminds us of how QuickBooks lock-in is reinforced by outside accountants who prefer working in QuickBooks.
- Data – due to its 200k+ customer scale, Klaviyo has far more data on ecommerce retention marketing than peers. Klaviyo’s legal terms allow it to train on aggregated/de-identified customer data. It sees how customers build flows, what good email campaigns look like, how end-users respond, etc. Even more valuably, it can see all the way to outcomes in a closed loop – the message, the deliverability and engagement, and whether it led to purchases. Over time (and we think it’s still early; this has not happened yet) this should enable it to build better AI products than peers and even general foundation models working without Klaviyo’s domain context.
- High switching costs, as discussed above. Klaviyo drives the revenue line, so replacing Klaviyo is not only operationally disruptive but also introduces revenue risk. Even if a competitor somehow comes up with a better product at a much cheaper cost, getting distribution to Klaviyo’s 200k+ customers, convincing them to switch, etc. will be a long journey.

On Shopify: Shopify has steadily improved its email product, but we don’t think an all-out push to match Klaviyo and then displace it is likely.

- It goes against Shopify’s philosophy. Shopify’s publicly stated philosophy is to build “what most merchants need most of the time” and “for everything else, we empower our ecosystem of developers to build for our merchants.” This mantra was confirmed to us by former Shopify employees we spoke to who led Shopify’s email product and app store. Trying to match best-in-class products in its ecosystem 1:1 and furthermore undercut them on pricing does not fit this philosophy and would be disruptive to its marketplace. This is made even more unlikely since Shopify owns a ~5% stake in Klaviyo, receives a ~4% revenue share on Shopify-related revenue, and the two companies collaborate closely on new Shopify product updates.
- It is low on Shopify’s priority list and as a result receives little headcount (we heard the team was ~30 at peak, vs. 2,300 employees at Klaviyo). Shopify has far bigger priorities and opportunities: agentic commerce, AI tools, payments, advertising, enterprise, international.
- When we speak with customers and partners, it is clear Shopify Messaging is not even in the consideration set, ranking far below independent email tools like Omnisend and Brevo. Perhaps this could change in the future, and we are on the lookout for any change, but we feel comfortable with this risk.

So we get to the third AI risk: whether the nature of the job to be done changes completely. Along with Braze, Klaviyo stock fell in September on perceived “Muse risk.” With the rise of consumer agents like Muse, will humans still read email or only agent summaries? If the effectiveness of email marketing is reduced, does customer spending on Klaviyo decline?

Our thesis on Braze and Klaviyo was the opposite, and we bought more on the decline – our thesis was that, as with past waves of disintermediation (DoorDash/Uber disintermediating food brands, Amazon disintermediating commerce brands, Booking/Expedia disintermediating hotel brands, Gmail filtering messages into Promotions, etc.), making the end-buyer harder to reach makes the best-in-class messaging platform more important, not less. Brands will not give up on trying to build direct relationships with customers, even if it’s harder – because the alternative is to passively accept disintermediation and shrink in relevance. This kind of time is when email/SMS deliverability matters most. Messages need to be more personalized, more targeted, and higher quality to cut through and make an impact.

For brands, email is an extremely high-ROI channel (an email through Klaviyo costs \$0.002), vs. expensive paid marketing that gets competed down in the marketplace to merely acceptable ROI levels. Even if the impact from agents is large and email marketing incrementally loses effectiveness (something we don’t necessarily believe – we think the jury is still out on 1) widespread consumer agent adoption and per-user usage intensity and 2) what effect that has on email, which we expect to remain as a central communication hub), there is enormous room for ROI to compress before it makes any sense to change email strategy (again, for brands, what is the alternative? To give up the cheapest and near-only channel to reach customers directly? Another possibility is to lean more heavily on SMS to complement email; Klaviyo would pick up SMS volume in that scenario). To make up for lost revenue, brands will likely use more AI decisioning and may send more, not less.

Separately, there’s also this thesis in the market that Shopify stands to benefit from Muse; Shopify stock initially dipped post-announcement before reversing and dramatically rallying as investors reassessed. If agents become a large shopping channel, this thesis goes (and we don’t necessarily agree), and Shopify provides the best integrations for long-tail discovery while Amazon blocks Muse, then Shopify merchants stand to benefit. Klaviyo stock didn’t receive this benefit, but it naturally follows that if Shopify benefits, Klaviyo benefits – because new customer contacts will be captured and then remarketed to via Klaviyo.

AI products

In our last letter we wrote about how AI poses risks but also opportunities for software. We are generally uninterested in rearguard action, “AI defense” theses where the main hope is that AI is not as disruptive as feared, but with little to no expectation of AI benefit. We invested in the software companies we did not only because they were cheap due to AI fears but also because we saw potentially significant *new* opportunity from AI, which was entirely unpriced.

Retention marketing platforms like Braze and Klaviyo are some areas where the potential opportunities seem clearest. Pre-AI, Braze and Klaviyo were manually operated execution platforms; a human decided what and when to send by mapping out elaborate branching decision trees (customer in VIP segment → send this email; if no response to the first message → send a text; customer in about-to-churn segment → send this discount code; if no response → send this bigger discount code, etc.). The execution platform is still needed as infrastructure, but AI gives these companies a new opportunity to additionally sell the “brain” behind marketing – messages personalized for each customer, near-fully automated campaigns, intelligent agent responses when customers reply, etc. Additionally, as AI makes the platform easier to use and automates more of email strategy (such as automatically building the decision tree above, which Klaviyo’s Composer can already do), customers can reduce the size of their email teams

and potentially renegotiate the services provided by agency partners, both representing a labor savings pool that could be partially recaptured as token revenue.

Klaviyo is led by a talented, technical founder-CEO who still commits code and is deeply involved in product. He and the team understood and invested in AI early, and in hindsight some of his comments that sounded strangely AI-pilled at the time now read as prescient today. Klaviyo so far has rolled out several AI products (Composer, Customer Agent, Klaviyo Personalization which does AI decisioning) that are early but rapidly gaining in functionality. We think Klaviyo has a right to win in this space (possessing data advantages and the execution layer) and we think this can potentially turn into a large opportunity.

Valuation

We expect Klaviyo will grow revenue by ~26% in 2026 and ~22% in 2027, with no assumptions for AI revenue. Our strong conviction in Klaviyo's growth comes not only from the unit economics (as of the latest quarter: 16% growth in customers, 36% growth in customers with >\$50k ARR, 109% net revenue retention, unchanged high S&M efficiency at increasing scale) but also because it is joined at the hip to Shopify (Klaviyo is effectively a default and a no-brainer for Shopify merchants above a reasonable revenue size), and Shopify continues to do amazingly well. We are big admirers of Shopify but consider Shopify uninvestable for us given its high valuation; thus, we see Klaviyo as a way to benefit from Shopify's growth but at a much lower multiple.

Klaviyo trades at 3.0x our estimate of 2027 revenue, a low multiple both in relative terms (far off the current trendline of revenue growth vs. revenue multiple for public SaaS) and absolute terms (vs. our estimate of mature GAAP profit potential) for a business that we rate highly in moat and quality. We think Klaviyo will continue growing strongly, trade to a higher multiple, and has the potential to 2-3x from today's price.

We find it very interesting that Bending Spoons has placed a reference price of ~2.5x ARR (2.7x for Airtable, 2.3x for Miro) on challenged software (Airtable is a distant #4 to Monday/Smartsheet/Asana, Miro is a point solution getting squeezed by broader suites bundling its whiteboarding functionality). We can't necessarily call this a floor, but it's a validation of the argument from our last letter that for quality software, a revenue multiple with a 2-handle already priced in a scenario where that company can be profitably turned into a high-margin declining annuity, and further fundamental downside would be unlikely. We think Klaviyo is far better positioned than those so far acquired and is an AI winner rather than an AI loser, but it's interesting to see an acquirer like this appear in the marketplace.

Business update

We are excited that Josh Chan has joined us as an analyst. Fitting our philosophy that great talent can appear anywhere and thus hiring should not be limited based on geographic location, Josh is based in Toronto and graduated from the University of Toronto. Prior to joining us in March, he worked at Centurion Asset Management and before that interned with our good friends at OceanLink.

We are also looking for a COO/CFO and hope to steadily make progress toward that hire. If you have anyone you'd recommend, please reach out to me.

Conclusion

We make our AI capex comments above from a longer-term view focused on 2028 and later; trading-wise, we have no idea where the AI capex trade goes next. It could rip back up (recent datapoints indicate

Anthropic ARR re-acceleration driven by Opus 5.5), and we go back to the most-of-2026 environment where everything non-AI sells off. It could tank further, potentially taking large caps and the indexes down with it; or anything in between. We remain focused on finding ideas in our sweet spot (with amazing products, high growth, and low valuations) and endeavor to both closely follow new developments in the world while also blocking out noise to focus on fundamental value when we make decisions. Our goal remains the same as at launch: to compound our money at high rates of return while making our best efforts to continually maintain safety of principal.

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

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