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"You don't need a parachute to skydive.. you only need a parachute to skydive twice."
– Unknown

Dear partners and readers,

Our return on capital in the first half of 2016 was 0.0% (that's not a typo).
Currency effects had a positive impact on our returns by roughly 0.9%. On an absolute basis we made money because some of you made well-timed additional investments during the period. Our total assets which are comprised of cash and investments were on June 30, 2016 worth [xxx] SEK.

Below are the pre-tax returns since the start of the partnership on Jan 1, 2013. To make the returns a definite "apples to apples" comparison, re-invested dividends are included in the partnership and in the OMXS30 returns.

	Zen Capital Partnership	**Limited Partners [1]**	**OMXS30 [2]**	**Difference**	**100 000 SEK invested [3]**
2013	41.0%	30.8%	25.4%	5.4%	130 800 SEK
2014	45.0%	33.8%	13.6%	20.2%	175 010 SEK
2015	35.1%	26.3%	2.5%	23.8%	221 038 SEK
June 30, 2016	0.0%	0.0%	(6.0)%	6.0%	221 038 SEK
Overall Gain	176.2%	121.0%	37.2%	83.8%	121 038 SEK
Compounded Annual Gain	33.7%	25.4%	9.5%	15.9%	

[1] Limited Partners returns are after all fees.
[2] As Avanza Bank now offers Avanza Zero – a fund that mimics OMXS30 returns including dividends and charges zero fees – the OMXS30 column shows returns after all fees as well.
[3] 100 000 SEK invested in the partnership on Jan 1, 2013.

A word on our returns

The past 14-month period since the OMXS30 index peaked on April 27, 2015 has been by far the best period in our short history. The index is down 23.1% since then while we are up 20.1% resulting in an outperformance of 43.2%. I am certain of few things in life but I am certain that such an outperformance will not continue over time. But let's enjoy it now.

I think our 0.0% return on capital in the first half of the year illustrates well the randomness of returns at a specific date. As Warren Buffett wrote many years ago: *"Our investments are simply not aware that it takes the earth 365 days to orbit around the sun. They are also not aware that I need to report to you at the end of each orbit."*

While I understand that a 0.0% return might not sound very exciting to anyone; if you are a fundamental long-term oriented investor the closing hours of June 30 were as exciting as it gets. As Larisa will tell you, I was cheering our companies on to maintain our streak of no negative 6-month periods; it long looked like it would be broken but a late night comeback by some of our companies allowed me to postpone that.

As I have said before I don't believe currency effects will have a big impact on our returns over time. I could definitely be wrong here but I have no plans to hedge our currency exposure. Usually, from what I have seen, the costs of hedging outweigh the benefits.

Don't lose money

Why do I think not losing money is so important so that I have made it our primary goal? First, it allows me to sleep well. Second, a person that compounds at 15% per year for 20 years without any losing years ends up with a 1537% return whereas a person that compounds at 15% but loses 50% in one of the years ends up with roughly a 600% return. Not bad either but as you can see, the difference is enormous.

I would like to clarify what I mean by not losing money. As much as I would like for us to never have negative returns in any one year, it's probably unavoidable that we will have some years in which our returns are strongly negative. What I try to avoid is a permanent loss in any one single investment. If a company's shares are down during one earth-sun-orbit that does not necessarily constitute a loss for us – as our purchase could have been made at a lower price in any previous earth-sun-orbit – and much less a permanent loss.

A permanent loss happens if the following three conditions are fulfilled:

1) It turns out that I was wrong on a company.
2) The market prices the company's shares lower than our average purchase price to reflect that mistake of mine.
3) I decide to sell at that time so that our loss is realized.

This is very different from the market disagreeing with us for now and I decide to hold on or buy more. So far, a permanent loss of any meaningful size has happened for us only once – the culprit was Billabong which was sold last year – and our total loss then was less than 2.5% of our capital.

Brexit

I did not anticipate Brexit nor do I know what its ultimate effects will be. As we are not in the business of market timing and as we do not invest in currencies; even if I had anticipated it I would not have made any major adjustments to our portfolio. Some of you might say: "Well, if you had anticipated Brexit and believed it would lead to lower prices all across the board, why not sell everything the week before and buy it back 10% lower after the vote?" The answer is that you could play that game but that is not what we do. I believe it is much better to realize that these types of events will happen from time to time. As an investor with a long-term horizon you have to accept that they will happen and that you won't be able to accurately predict most of them.

What was clear was that the financial markets underestimated the probability of Brexit and were largely positioned for Remain – hence the big negative reaction when the result was announced. This was a bit surprising as the polls showed close to a 50/50 split just days before the vote.

After I sadly noted that Brexit had prevailed, at 9am when the markets opened I brought our cash and sat ready to deploy some of it when literally every stock went on sale. Given how the whole thing looked I should have brought some popcorn too. While it surely was entertaining I take no pleasure whatsoever in the panic of other people – I am just focused on making good investments at good prices on Zen Capitals behalf and widespread, uninformed fear tends to produce opportunities to do just that. The late June sale, which lasted a couple of days, allowed us to substantially lower our average purchase price in a new investment in a Norwegian company and to buy back Fortnox at a good price when the Visma offer was rejected (more on that later).

I don't know whether the world will be worse or better off with Brexit. I think it's fair to say that no one really knows at this point. It is way too early to tell what the initial effects will be and even more futile to try to guess any second and third-order effects. The main risk that I see is the possibility that other countries might follow in the future. I don't want to speculate as to what might happen then but I don't think it would be pretty. What everyone seems to agree on is that implementing Brexit will be a very complex and time-consuming process.

What we know with certainty at this point is that the British Pound (GBP) has lost some value versus most other currencies. This affects companies that have revenues or costs in GBP and report in some other currency, or vice versa. The former will now report lower revenues and costs all else equal while the latter will do the reverse. In our portfolio there is only one company, Fiat Chrysler Automobiles that has such an exposure. My estimate is that the GBP currency move will affect Fiats total sales (in EUR) by less than 0.5%.

Whatever the ultimate effects of Brexit will be, one can draw the same conclusion as always when it comes to predicting macro events in order to improve your investment returns: predicting macro events is incredibly difficult *in advance* and incredibly easy in hindsight.

If you don't agree, why didn't you tell me two years ago that: 1) oil would cost $43 a barrel, 2) that the entire stock of Swiss government bonds would trade at negative yields which means that if you want to lend your money to the Swiss government they will charge you for it, and 3) that the stock markets would be making new all-time highs under these conditions.

Investing essentials

During the year I got into a discussion about investment books and how the best-sellers are always the ones that promise some quick-and-easy scheme to riches. As Howard Marks has discussed: By definition, everyone cannot attain above average results. To get above average results you have to do something different than the majority. The books that are truly helpful are usually not popular in the mainstream because they encourage saving, patience, risk management, skepticism, reading annual reports, thinking deeply about companies and other "boring" things that won't score you many ohs and ahs from your friends, wife or family.

When I thought about it some more and having read hundreds of investment and business books; these five points is how I would summarize the essentials of investing for those of you that don't mind to save some time:

a) **Understand that the market goes up and down but mostly up.**
   Accept that you can't predict the moves, don't spend much time and energy thinking about those things.

   The market does go up over time as productivity and humankind advances. If either stops to advance permanently, you will have bigger problems than your investment portfolio.

b) **"Offense wins games, defense wins championships."**
   Never expose yourself to the risk of going broke, be humble and flexible, and learn to be content with moderate gains.

c) **Know your Circle of Competence and make big investments very seldom.**
   Work on expanding your Circle of Competence but only invest inside of it, no one cares how many things you put in the "I don't know" basket. Most companies are not great investments *for you*. This is crucial to understand.

d) **Always get the facts.**
Sometimes the important facts are not conveniently served up to you – that doesn't make them less important.

Sometimes the facts falsify your previous conclusions and you badly want to reject them – this is when recognizing them becomes even more important.

e) **Focus your time in areas that you find interesting and fun.**
This will speed up your learning, improve your understanding and more importantly, improve your life.

The rest is in doing the actual work and finding your own way. I believe there are many ways that work in investing as long as you don't stray too far from the above principles.

Our portfolio

Fortnox
I wrote in detail about Fortnox in the last letter, it might be helpful to revisit that part to get a better context before reading on.

On March 14, Fortnox main competitor Visma announced an offer to acquire Fortnox for 24 SEK per share. This was just above a 30% premium to the then current share price. The total deal value was 1.4 billion SEK. Visma's requirement for acceptance was set to only 50% which would mean that anyone who didn't accept the offer and held onto their shares would become a sort of a hostage with Visma as the majority owner.

The Board of Directors used almost 1 million of shareholder's money to pay a well-off firm for one weeks work to get a fairness opinion on the offer (in their defense, this is required under the Swedish takeover rules). This firm released a statement in which they assessed the offer as "reasonable from a financial perspective" without citing a single number; no growth assumptions, no future cash flow estimates and not a word on how they had valued Fortnox. To anyone not intimately involved in their process the statement was, well, "meaningless from a financial perspective". Understandably, Fortnox largest shareholder Olof Hallrup that owns 24% of the company was not very happy about how the offer had been handled by the Board and publicly announced that he thought it was too low and was going to vote No.

Now, as we owned about 0.05% of the company at the time of the offer – while I fully agreed with Olof – our situation was quite different. After the offer was announced the share price settled around 23 SEK, a 4% discount to the bid, assigning some probability to the offer not going through. Given that I wanted to maintain our ownership but not as a hostage to Visma, our options were as follows:

i. Sell our shares at 23 SEK and hope that the offer would be rejected → **0% return**.

ii. Keep our shares and hope that a higher bid would be announced → **Unknown upside**. I gave this a very low probability as I couldn't think of any other potential suitors.

iii. Keep our shares and vote Yes. This would have given us 24 SEK per share if the offer was approved by shareholders and by the Swedish Competition Authority (KKV) → **4% upside**.

iv. Keep our shares and vote No with the hope that the offer would be rejected and that the shares would become worth more than the offer price at a later date. I believed this would result in a much lower share price in the short term – my best guess was 16 to 18 SEK per share based on what the price was before the offer was announced. → **30% downside**. (if my estimate is a range I always assume the worst case, i.e. the lower limit, as surprises on the upside are not as unpleasant)

The Board hired another Corporate Finance firm at another hefty cost to shareholders (total costs related to the Visma offer per June 30, 2016 was 3.2 million, it's not cheap to get an offer to be acquired!) to help find other bidders but when no new offers were announced our options were to sell at 23 SEK or wait for a 4% upside provided that shareholders and KKV approved the transaction with a 30% downside if they didn't.

I believed there was about a 60% chance for each approval which meant that there was only about a 35% chance of both happening. Basic probability then gave us an expected negative return of 18.1% (0.35*0.04 - 0.65*0.30) if we held the shares. Besides this unequivocal math I believed that it would take a long time to finalize the offer given KKV's involvement. In addition, the fairly high possibility of the shares becoming available at a much lower price made it an easy decision in the end so we sold our shares at 23 SEK.

Shareholders approved the offer by a wide margin but on June 27 our prayers were answered when KKV announced that they opposed the acquisition and would try to stop it. Visma responded by withdrawing their offer. Because of Brexit there was some additional selling pressure – never mind that Fortnox only has Swedish operations – so the shares became available at a 35% lower price and we were able to buy back all our shares and then some which means we now own a 50% bigger piece of Fortnox without having spent any additional money. Aren't sales great? Compared to regular retail sales, in addition to the economic advantages, stock market sales are also much more enjoyable as there are never any long lines at the checkout desk.

We did not buy Fortnox – this time or initially in 2015 – at anything near a "perfect" price but Fortnox has many of the attributes I look for in a great business. Fortnox has a very strong competitive position in the marketplace, recurring revenues with very high retention rates due to the high switching costs that I discussed in the last letter, little to no inventory, it benefits from network effects which lower its marketing costs, its main product is required due to regulation and its products provide a great value proposition to their customers – the best services at the lowest prices.

The buyout offer goes to show how important it is to look to the future and not the past when evaluating a business. If you would have looked at Fortnox on a trailing 12 month basis at the time of our purchase (our average cost was slightly less than 15 SEK) it would have no doubt looked very expensive. But, as you know or may remember from the last letter, the value of a company is the sum of all future cash flows discounted back to today (plus its net assets). Past cash flows have nothing to do with it.

The future is all important and Fortnox dominant position is key here. Fortnox is quickly becoming the de facto standard for small companies in Sweden. New customer inflow accelerated in the first half of the year from the already high growth rate of the last couple of years. Revenue per customer also showed a substantial increase; this is a very important metric as it indicates that existing customers order add-on services at close to 100% margins for Fortnox. Some new financial services that Fortnox recently launched bode well for a continued increase in revenue per customer in the future. The resulting effect on earnings should be good. I believe Fortnox is worth more than what Visma offered and possibly even a lot more in a couple of years.

Diamond Resorts International

Diamond Resorts is a vacation ownership company. It offers a membership that gives its customers the ability to choose vacation destinations among hundreds of destinations around the world. They charge a high price for their memberships and so their services appeal primarily to higher-income families. I first read about this company in a letter written by Scott Miller at Greenhaven Road Capital and started researching it. This resulted in an investment that I expected to be more short-term in nature than what we normally do as I liked the price very much (our average cost was around 5x my free cash flow estimate) but wasn't very excited about the business model.

A couple of months later on June 27 when Visma's offer was withdrawn I decided to make this money available to buy back Fortnox and leave what I assessed to be a 15-20% upside on the table. Had the KKV announced their decision on Fortnox two days later our portfolio would have been subject to yet another buyout offer and another 30% premium within a mere four months as Apollo Global Management announced an offer to acquire Diamond Resorts on June 29. While this possibility was not the main reason for our investment, Scott actually predicted the buyout within this timeframe based in part on a large chunk of options owned by management that were going to expire in July. Credit to him and an eventful final week of the first half of the year for us to say the least.

Yes, I know. An argument can be made that I should have left this one alone as I am a proponent of investing based on long-term fundamentals and estimates only. In hindsight, I actually agree with that argument. In my defense I call upon what writer and philosopher Aldous Huxley once wrote: *"The only completely consistent people are dead."*

Fiat Chrysler Automobiles
Despite what the share price and the media would have you believe, Fiat is actually doing pretty well. Earnings have been steadily rising and while the re-investment needs are high, I continue to believe that Fiat shares will be worth much more in a couple of years. With that said, as the auto business doesn't have very attractive overall economics, Fiat is one of our smaller positions. But it's still meaningful as we never hold more than ten positions.

Interest rates

Warren Buffett highlighted something very interesting in an interview earlier this year: he said that if we knew for sure that interest rates would be 0% for 50 years the valuations would go through the roof. To understand what he was talking about: Imagine if we knew that interest rates were indeed going to be 0% for the coming 50 years. What would happen?

Well, the attractiveness of investments is a lot about its available alternatives. If your only alternative is to get a 0% risk-free yield and you know it will be your only alternative for the next 50 years, you will be very happy with a 5% yield or a 20x earnings multiple (if you buy a company for 100 units and they earn 5 units per year you pay 20x earnings and earn a 5% interest on your investment assuming all earnings come to the benefit of shareholders) and even fairly happy with a 1% yield or a 100x multiple. Actually, any positive yield would be preferable to 0%. Thus, very high multiples would make perfect sense in such an environment.

Now, if you can get a 5% risk-free yield, or if you believe that you can get 5% risk-free in a couple of years, you will demand say an 8-12% yield in order to be willing to take on some risk. You are not going to accept a 5% yield *with* risk when the government offers it to you risk-free.

Another effect of today's low interest rates is that future cash flows have a higher present value. A dollar tomorrow becomes almost equal to a dollar today. Some investments that in a more normalized interest rate environment would have been done in a couple of years will make sense to advance and do right now instead because of the higher return on investment (due to the higher present value of future cash flows) and also the cheap borrowing costs. This added investment demand also drive up prices. A result of all this is that the market assigns fast-growing companies higher multiples. This is to some extent warranted. But markets usually overshoot and some companies are now priced as if they have found an elixir of eternal life and patented the solution.

In summary, first of all we have to remember that we do not know that interest rates will be 0% for 50 years. Most of us would agree that this is extremely unlikely. Secondly, although higher valuations are warranted to some extent, it has become harder to find good companies at cheap prices. As I write this, although I am always on the lookout, we are at 20% in cash.

Feeling lucky

As an investor it's very enjoyable to be able to wake up every day and go to learn more about subjects that really interest and fascinate me. I wish our society would encourage more people to do that. Yes, it's up to each and every one of us to find and go after what we most of all want to do with our time on earth, but our societal values sometimes make it hard for people to take the time to really think about that – there are always so many things that "need" to be done first and it's not very socially accepted to talk about these things. People tend to call it "midlife crisis" when what it really should be called is "I'm thinking hard about what I really want to do in life".

There's nothing wrong with not knowing but it's a big mistake not to do everything you can to find out. It might not be easy to get started (I know this well from experience) but someone has to put you on the right path. And that someone has to be you. I think Oprah put it very well: *"If you don't know what your passion is, realize that one reason for your existence on earth is to find it."*

Your life will be enormously improved and much more fun and interesting once you find something you truly enjoy to do every day. It can be hard to know what you like the most so it might be easier to start with what you don't like and eliminate that. When I worked as an employee many years ago I had no idea what my dream job was but I knew all too well that that wasn't it. How we spend our days is ultimately how we spend our lives. Unfortunately, our time is limited and to not forget that I regularly remind myself of Mary Oliver's challenging line: *"Tell me, what is it you plan to do with your one wild and precious life?"*

I have a confession to make. I remember when I started out on this investing journey about six years ago with no firm idea of a strategy and less than 150 000 SEK. I believed that managing millions is what "they" do and I couldn't imagine any remotely viable path to ever getting there in a lifetime. It was something that was just beyond my reach. The sum that I manage today – about [xxx] million as I write this of which almost half are profits – was completely unfathomable to me at the time.

You might think "Well, what's so special about making much money?" You're right, making much money in itself is not special at all. It's about the improvement that's possible if you put your mind into something that fascinates you and comes naturally to you, and about overcoming the illusory limitations we tend to put on ourselves.

If you feel like I did regarding anything that fascinates you but seems completely out of your reach, know that most things, especially those that have been achieved by others, are indeed very possible. A lot of hard work and patience will be needed but most often, the people in your area that are where you want to be are usually not much different from you; they've just been more focused and have been at it for a longer time.

One of the reasons I really like investing is because in the end the person with the facts always wins over the person without. In politics, serving as a current stark contrast, you can apparently be on track to get 40% of the votes in one of the Western world's largest countries by primarily making things up and then shouting loud about them. Independent fact-checking bureau PolitiFact.com found that more than 75% of one of the candidate's statements (I will leave it to you to find out which one) were mostly false or worse. In investing, shouting won't get you any points and making things up will bankrupt you.

Personally, I would have liked a solution where all politicians are scored on their truthfulness leading up to the election. Today, the drawbacks of fiddling with the truth are almost non-existent. This "truth score" would then play a big role in the election and matter as much as all the votes. I think this would lead to less emotional elections and make for a better world.

On a final and happy note, our partnership has now created its third millionaire. I intend to keep working hard to multiply that number. While I have always liked numbers in general, this number – along with helping other less well-off people down the line – means much more to me than most other numbers.

Daniel Glaser Uppsala 2016-08-24

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