Fellow Shareholder,

River Oak's book value per share decreased by 5.9% in 2018. Our book value at Dec 31, 2018 was SEK 15.6 million, which is equivalent to SEK 102.12 per share. This compares to a decrease of 10.8% for the OMXS30 index in the same period. If you had invested in the index you would also have received dividends of approximately 3.6% which would have brought the net result for the index to a decrease of 7.2%.

	Investment return	Change in book value per share	OMXS30 incl. div.	Difference
2017 (from Feb 7)	13.2%	**8.6%**	5.4%	3.2%
2018	0.0%	**(5.9)%**	(7.2)%	1.3%
Total gain	13.2%	**2.1%**	(2.2)%	4.3%
Compounded annual gain	6.8%	**1.1%**	(1.2)%	2.3%

For those of you that prefer to look at two full Earth orbits around the Sun since we started on Feb 7, 2017 (one complete orbit takes 365.256 days), our book value at Feb 6, 2019 was SEK 18.7 million, which is equivalent to SEK 121.88 per share for a total net gain of +21.9% at our 2-year mark. The return for the OMXS30 including dividends was +7.8% during the same period.

When evaluating investment results, it is my strong recommendation that you always look at the longest time period available as shorter time period won't tell you much of value. I have included a 6-year track record, which includes the results of my family partnership from 2013-2016, at the end of this letter.

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Raising capital

As you know, we have had a good start to the year. In March, we raised capital at a 1% premium to our book value as per March 31, 2019 which resulted in an offering price of SEK 134.77 per share.

We are now 33 shareholders that span all the way from doctors and professors to software developers to managers, business owners and CEOs. A warm welcome to our new partners that have made our motley shareholder crew even merrier!

As per previous communications we plan to raise capital quarterly from now on. The next opportunity to invest will be at the end of June.

Our results in 2018

I will not bore you with more comparisons of investment returns or more discussions about the market downturn at the end of 2018. There are thousands of investment letters all over the world that have done that (and I discussed both subjects in the 2018 update and in my Annual meeting presentation). Instead, I will focus this letter on how I go about selecting our investments and the lenses I use for evaluating them.

But first, a short comment on the difference between our book value per share decrease of 5.9% and our investment return of 0.0%. The reason for the difference is because we reserve salary costs and related taxes quarterly and not annually. Per the end of the third quarter in 2018 we had a substantial gain for the year, at which point salary and related taxes were reserved, which left us with a book value per share of SEK 130.23 at the end of the third quarter. As you know, our book value per share needs to end a quarter above the highest previously recorded level before any further salary can be reserved.

For the curious, I took out all the reserved salary that was available at the time of our August-2018 capital raise (we sent roughly half of it to the Swedish Tax Authority as usual), I added an additional SEK 300,000 of personal capital, and then re-invested the full combined sum into the capital raise, which was completed shortly before the severe market downturn in the fourth quarter gained momentum. This is exactly as it is supposed to be as I see it: If River Oak does poorly, I will too. (The only party that was spared in the market downturn in this transaction was the Swedish Tax Authority. All good.)

During the year, I let the Board know that I am open to start reserving salary costs annually instead of quarterly. After some discussion we decided to continue to reserve salary costs quarterly as our book value per share would otherwise be very misleading in positive years as we would reserve all salary costs for the whole year only at the end of the fourth quarter. This would lead to an artificially high book value in all other quarters.

The salary costs we reserved in 2018 should be viewed as similar to making a prepayment on rent. As a result of the salary "prepayment" we made in 2018, and our high water mark model, we have had a positive effect on our 2019 year-to-date net result of 5.9%, which is exactly equal to the negative effect we experienced in 2018. If events had instead turned out such that our yearend book value per share had been the same as per the third quarter, i.e. SEK 130.23, we would have had no negative effect in 2018 and no positive effect in 2019.

Ok, enough of that fun stuff. If you're still with me, let's look at our investments.

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Our Investment categories

At the end of last year, I divided our investments into three main categories.

"The Goods" - This category consists of decent businesses that I believe have a good future but which are priced by the market as if they had anything but. The companies in this category are generally not great businesses. As a consequence, this is currently – and is likely to continue to be – our smallest category.

"The Greats" - This category consists of companies that have solid profitable business models and are growing at healthy to very strong rates. These companies generally have a strong track record of innovation and adapting well to new trends due to entrepreneurial cultures and minimal bureaucracy. They are most often, but not always, market leaders. This is currently – and is likely to continue to be – our largest category.

"China" - Our third category consists of companies that operate in China. This bucket has tended to have some overlap on price with "The Goods" and on quality with "The Greats". We almost always prefer the high quality business over getting a great price.

The Greats

As "the Greats" is our largest bucket, and as the qualities of its companies serve as the primary basis for selection in our China bucket as well, I thought it most interesting to focus on the selection process of this category.

Negative filters

There are hundreds of thousands of companies around the world that are available for us to invest in. Where does one even begin? There are a couple of filters that I use to eliminate a majority of the available universe:

1. **A bad business**
   During the Dot-com Bubble in the late 1990s, there was one company called Priceline.com that operated a software platform to sell airlines' excess inventory online. This was a good idea. However, they paired this good idea with a less good idea: to let their customers choose the prices they were willing to pay for tickets. Despite the fact that Priceline was losing $30 on average per ticket sold amid initial slow demand, it became a real market darling with a market value of more than $20 billion at its peak before losing 99% of its market value when the bubble burst.

   In our investments we want to have a solid business model, which at its core and at reasonable scale, is profitable.

   (Priceline actually went on to become a very good and profitable business after it changed its business model. It has today become one of the great businesses of our time with its 2005 acquisition of online hotel booking platform Booking.com. Priceline changed its name in 2017 and is now called Booking Holdings.)

2. **Strong cyclicality**
   All our investees (except Fiat Chrysler) operate within secular growth trends, i.e. longer-term trends, as opposed to cyclical shorter-term trends. So if there is a slower economy, I still expect them to do well. We don't want to be completely in the hands of the fickle mood swings of the overall economy.

3. **A bad culture**
   When a company runs into big problems, it's often a bad culture underneath that is the root cause. A bad culture is very difficult to change. While great companies don't always enjoy early success, they almost always get the culture right from the start.

4. **Turnarounds**
   I was recently in Ukraine for a few days. Conversations there can go as follows: *"So when you turn the hot water tap you actually get hot water? Wow, that's great."* It is often considered a luxury when things work as they are supposed to.

   Despite the tremendous potential a country like Ukraine harbors, one lifetime is only so long. We stay away from companies where many things need to be fixed. One rare exception to confirm the rule that comes to mind is what Sergio Marchionne was able to do at Fiat and then Chrysler.

Positive filters

As many companies in our investment universe are eliminated using the above filters, what positive attributes do I then look for? Our favorite companies have some or all of the following characteristics:

1. **They provide very basic products and services which consumers and businesses absolutely need in their everyday lives.**
   The big advantage of providing the shovel in the gold rush is that you don't need to find gold to do well.

2. **They are simple companies whose businesses are easy to understand.**
   We don't invest in companies with business models or products that require an MIT degree to comprehend.

3. **Their customers see the product or service as such a natural part of their lives that they don't even think about paying the bill.**
   Their customers see the product or service similar to how we think about paying rent or the electricity bill.

4. **They provide a product or service that truly helps their customers.**
   This can for example be done by saving the customer money, saving the customer time, or both. It can also be done by providing the customer with an offering that is somehow unique – for example, the superior selection that a dominant classifieds platform or marketplace can offer its customers compared to its competitors.

5. **They have many customers that all comprise a very small part of the company's overall revenues.**
   It can be risky to have a couple of large customers that constitute a meaningful part of a company's overall revenues. We prefer companies that have many small customers so that any one customer cannot meaningfully hurt the business.

6. **Market leadership**
   This is valuable in many ways but the two primary advantages of an established market leader are larger scale and lower marketing costs (due to mindshare and word of mouth) than its competitors. These two factors result in overall better economics for the market leader than its peers: the product or service that it sells can thus be sold more profitably, with a better service level or at a lower price, which in turn brings in more new customers and increases the loyalty of current customers.

7. **They grow quickly, but not too quickly.**
   Our sweet spot is somewhere between 10% to 25% revenue growth with accompanying higher earnings growth due to operating leverage in the business model. A slower revenue growth, say 5%, in a company that has strong operating leverage can in some cases be preferable to 50% revenue growth because the latter is usually not sustainable for very long. Miracles, even though wildly touted by investors in "hope-and-dream" companies, seldom happen.

Examples that come to mind of investments we have made at River Oak that have many or all the above characteristics are Verisign, Fortnox, classifieds companies like Schibsted/Adevinta, cloud service providers and payment providers.

Focusing on the right things

A key to success in most endeavors in life is to look at things through the right lens. When one is in her happy place where everything is calm and clear and goes according to plan, we are generally focusing on the right things. When one gets many external influences or when things start deviating from one's plan, it can be easy to lose sight of what really matters. So what lenses are important in investing?

1. **It's all about businesses, not stocks**
   There is much talk about value stocks, growth stocks, dividend stocks, emerging market stocks and a handful of other popular baskets. At River Oak, we couldn't care less what label people put on the businesses we have ownership stakes in. Our focus is solely on making intelligent investments in good businesses.

   The father of value investing, Ben Graham, is most well-known for his brilliant concepts of Mr. Market which entails viewing the market as your business partner that offers you thousands of deals at different prices every day, and of Margin of Safety which entails always incorporating a margin for error in your investment analysis in case things turn out worse than you expect.

Personally, I think his most important investing principle is *"Investing is most intelligent when it is most businesslike"*.

Make the correct business analysis, and the stock will eventually follow. You must first learn how to analyze businesses before Ben Graham's other two principles become useful. I happen to know this from experience. In my early years, I was very aware of the Mr. Market and Margin of Safety concepts. In fact, I was rather proud of how I wasn't bothered by the mood swings of Mr. Market because I knew I had my Margin of Safety. However, as my business analysis was frequently wrong, my Margin of Safety was often illusory, and instead of taking advantage of this phenomenal business partner we all have in Mr. Market, I became his go-to guy. Whenever he had a problematic business he wanted to offload, he came to me and I was regularly a willing taker.

If you want to be a good investor, there is in my mind nothing more important than business analysis.

After that, the concepts of Mr. Market and Margin of Safety can become huge additional advantages.

2. **The market value of a company does not equal the intrinsic value of a company**
   The market value of a company is what all market participants have jointly agreed upon to buy and sell it for at a certain point in time. The intrinsic value of a company is the sum of all future excess cash flows discounted back to today at an appropriate discount rate. Most of the time, the two match reasonably well. On occasions, they differ wildly.

3. **Time perspective**
   When you start looking out 2 to 5 years, instead of 2 to 5 weeks or months, the world of investment opportunities will start to look completely different.

   As an example, when I first invested in Fortnox in 2015, its enterprise value was around SEK 750 million. At that time a lot of investors thought the company was much overvalued and were debating whether it was worth 500 million or 1 billion. Today, only four years later (admittedly, with the benefit of hindsight) with earnings comfortably exceeding SEK 100 million, no one is claiming that the fair value is in the hundreds of millions anymore. The debate has moved to the billions now.

   The valuation discussion that many investors had in 2015 is a great example of short term noise that can really cause you to lose focus on what matters in investing. Getting caught up in short term noise – whether it is current earnings or recent bad news – is something we avoid at all costs at River Oak. Such thinking can cause you to miss the best opportunities.

Besides, looking out a couple of years is much more fun too! Why? Over a longer time period, the changes are much bigger than they are over one month or one quarter, which not only gives you a much greater chance to predict the range of outcomes but also opens up the opportunity to make a truly meaningful profit if you're right.

4. **Recognizing reality**
   I have seen investment operations that proudly announce that *"Our returns in year X were Y% despite us having an average cash balance during the year of 20%."* implicitly implying that returns could have been a fair bit higher had they not carried this large cash balance.

   That's akin to saying *"I came in 2nd place in my marathon race despite only running 80% of the time. Imagine what would have happened if I ran the whole race!"*

   Well, we will never know.

   In investing, what you thought about but did not act upon, counts for no more than what you didn't think about at all.

Founding principles

(always included in the annual letter)

Our basic idea is simple:

1. **Make a bet on human progress.**

   Human progress is the reason why stock markets in the jurisdictions we invest in have historically produced average annual returns of 6% to 10% over the past 100 years.

2. **Invest in companies that are better than average or available at lower prices.**

   The objective here is to add some additional returns on top of the 6%+ returns that the general market has provided and is likely to keep providing investors over time.

Goals

(always included in the annual letter)

1. **Don't lose money.**

   We always think about the downside first.

2. **Earn an average of 15% annually on our capital over time (pre-tax in SEK) which will result in an annual increase in book value per share of 11% after taxes and operating costs.**

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Closing remarks

In some sad news, one of my big heroes, Fiat’s former CEO Sergio Marchionne, passed away in July. He will be deeply missed by both employees and investors all around the world. He should be remembered as one of the great CEOs of our time; in terms of jobs saved over his career, there can’t be many that come close to the impact he had. The current management team at FCA and their recent bold and constructive actions stand as a testament to the lasting impact Sergio had. Don’t miss the book with his name that will soon come out in English.

As our second year has come to a close, I would like to thank Anna Åhr and Stefan Sjöö for their work on the Board. Our Board has a lot more experience and good ideas thanks to them (and less of my bad ideas which are argued down before they cause us any harm). They are also kind enough to provide their expertise without direct compensation. They get paid, through their share ownership, only if River Oak’s book value per share increases over time. In other words, the Board’s goals are perfectly aligned with all other shareholders, just as it should be. After all, the Board of Directors is there to represent shareholders and nothing less. Next time you see Anna and Stefan, please give them your thanks.

We also have high accountability for the pilot. It is rumored that Roman engineers were required to sleep under the bridges they had built. While this rumor seems to be nothing more than an attractive metaphor, I am indeed sleeping under “our bridges” every night as I and my family have invested essentially all our liquid net worth in River Oak and a family partnership that invests in the same companies as River Oak – I most often sleep in peace, and on the rare occasions when I don’t I make the necessary adjustments the next morning.

Just over two years in, I couldn’t be happier with how we have set up River Oak to succeed over time. In addition to the perfectly aligned governance, we have two equally valuable traits: permanent capital and an extraordinary group of shareholders that are here for the long-term. It also warms my heart that most shareholders were not multimillionaires to start – this gives River Oak a good chance to serve its wider purpose: To make a real difference in people’s lives.

I wish you all a great summer.

May 31, 2019

Daniel Glaser
Chief Executive Officer

Historical pretax returns

Feb 7, 2017 – Dec 31, 2018: River Oak Capital AB
Jan 1, 2013 – Feb 6, 2017: Zen Capital Family Partnership

	Investment return	Net return (pretax)	OMXS30 incl. div.	Difference
2013	41.0%	**30.8%**	25.4%	5.4%
2014	45.0%	**33.8%**	13.6%	20.2%
2015	35.1%	**26.3%**	2.5%	23.8%
2016	20.5%	**15.4%**	9.1%	6.3%
2017	19.6%	**14.0%**	7.0%	7.0%
2018	0.0%	**(5.9)%**	(7.2)%	1.3%
Total gain	298.1%	**173.4%**	58.2%	115.2%
Compounded annual gain	25.9%	**18.3%**	7.9%	10.4%

* Startup costs for River Oak Capital AB had a 0.8% negative impact on the 2017 net result.

Approximate currency effects on investment return:
2014 +7%, 2016 +2%, 2017 -10%; 2018 +5%, other years <1%.

River Oak does not in any way strive to foresee or profit from currency movements. We believe that any impact from currency movements on our results will be negligible over time.

Online book shelf

https://www.goodreads.com/review/list/68472482-danielg

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