River Oak Capital

# 2022 Letter to shareholders

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River Oak's book value per share decreased by 28.8% in 2022. Our book value on December 31, 2022, was SEK 94.1 million, equivalent to SEK 210.77 per share.

| | Investment return (pretax) | Change in Book value per share | OMXS30 incl. div. (pretax) | Difference |
|---|---|---|---|---|
| **2017 (from Feb 7)** | 13.2% | **8.6%** | 5.4% | 3.2% |
| **2018** | 0.0% | **(6.0)%** | (7.0)% | 1.0% |
| **2019** | 61.7% | **50.1%** | 30.7% | 19.4% |
| **2020** | 104.0% | **74.3%** | 7.4% | 66.9% |
| **2021** | 14.3% | **10.8%** | 32.7% | (21.9)% |
| **2022** | (26.9)% | **(28.8)%** | (13.0)% | (15.8)% |
| | | | | |
| **Total gain** | 212.1% | **110.8%** | 59.0% | 51.8% |
| **Compounded annual gain** | 21.3% | **13.5%** | 8.2% | 5.3% |

The difference between our investment return and change in book value per share in 2022 is comprised of taxes paid in the period (approximately 0.65% of the difference), operating costs (~0.45%), and the use of our so called "float" (~0.8%).

Float is a liability on our balance sheet that we can use temporarily for investment until a predetermined payout date. We initially got some float at the beginning of 2021 when we reserved salary costs for the coming three years out of our 2020 profit pool. It worked to our advantage in 2021, and to our disadvantage in 2022. I expect that the use of any float we may have will work to our advantage in most years.

When evaluating investment results, it is my strong recommendation that you always look at the longest available time period as shorter periods with their inherent randomness won't tell you much of value. As always, I have included a full track record of the past ten years which includes results from my Zen Capital family office from 2013-2016 at the end of this letter.

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**Notes to table**

[1] Change in Book value per share is reported net of a dividend on class A shares according to the Company's Articles of Association, taxes, and general operating costs. There is no dividend on the class A shares unless the yearend book value per share is higher than all previously reported years. For more details, see the Company's Articles of Association.

[2] The OMXS30 incl. div. column does not include the standard annual tax payment on Swedish investment accounts which amounts to between 0.4% to 0.5% of total capital per year and which River Oak pays every year. The real return achieved by a Swedish investor that invested in the index is thus between 0.4% to 0.5% lower per year than reported in the table, and the real difference achieved by the same investor is between 0.4% to 0.5% higher per year than reported in the table.

[3] Estimated currency effects on Investment return: 2017 -10%; 2018 +5%, 2019 +3%, 2020 -6%, years not mentioned <2%. River Oak does not in any way strive to foresee or profit from currency movements. Our belief is that any impact from currency movements will be negligible over time.

**Fellow shareholder,**

One way to sum up our 2022 business year is with the following:

*"Faced with the choice between changing one's mind and proving that there is no need to do so, almost everyone gets busy on the proof." – John Kenneth Galbraith*

At the start of the year, I got busy on the proof, until the evidence clearly showed it was time to reconsider.

Our result in 2022 is certainly nothing to write home about, but given where we were in July, I'm encouraged by how we ended the year. Over the past three years, our book value per share increased by an average of 11.2% per year compared to 7.4% for our benchmark, a slightly lower average than in our initial three years, but acceptable and in line with our goals.

As I have said many times before, I can never promise you results. I *can* promise you unwavering effort and commitment. I can also promise you a common destination for all of us. I have no diversification of my liquid net worth outside of River Oak and my family office (which is invested in the same companies as River Oak). Whenever your investment is marked down, you can quietly repeat to yourself: *'For every dollar my investment is marked down, Daniel's family's investment is marked down more, and significantly more in terms of percentage of net worth.'* While that may seem like a small consolation during rough stretches – as an investor, I take great comfort in knowing that my interests are completely aligned with those of the pilot. As you know, this is not as common in the investment industry as it is in the airline industry.

In fact, I have little diversification of friends outside of River Oak as well. Wherever Larisa and I go nowadays, there is almost always a shareholder there. You can be certain about few things in life, and one of them is that I will be here in the good times and the bad times.

I have previously stated my preference for reporting results to you as infrequently as possible since large swings tend to smoothen out over time, and the fewer chances investors get to worry about their investments the better off they usually are.

Let me highlight a case in point. Between our January low which occurred on January 25th shortly before our capital raise, and December 31st, our investment return was positive 3%. In other words, if I had not reported to you in between those two dates, you wouldn't have known about *any* fluctuations in the value of your River Oak investment due to the war, inflation, interest rates, or anything else that hit the markets and our portfolio in the past year. Call me crazy, but I believe some of you may have preferred that. In fact, large fluctuations have occurred for us most years (although they haven't been this large before). It has just so happened that most often these fluctuations recovered by the reporting dates such that you didn't notice.

## Comeback after a challenging period

I do love a challenge. In fact, the bigger the challenge, the more excited I get. It's not that I was trying to put us in a tough situation, but a cocktail of adverse events including, but not limited to, mistakes by yours truly, had us in somewhat of a pickle by July.

In 2020, I said: *"I believe the only way to identify real portfolio risk is to look at what is left after it has been exposed to a few real-life tornadoes. I'm sure we will face more tornadoes, but so far, I believe we have passed this test with flying colors."*

In 2022, we did not pass with flying colors. I should have asked tougher questions and demanded better answers from some of our companies. It's deeply ingrained in human nature to not ask the tough questions when everything is going up and to the right – this is also when it's most important since this is when it can make the biggest difference. I also allowed my focus to drift into situations I shouldn't have spent much time on at all. The effects of my detours into a few poorly chosen places in the past few years didn't show up anywhere in our results until last year.

So, what was key in turning things around in the second half of the year?

One big difference compared to previous drawdowns in which I have basically been sitting tight and only increased a few current holdings was that some meaningful changes were warranted this time. There is no rule that forces us to recover drawdowns in the same way that we suffered them. While it's a great feeling to be proven right, especially about something as notoriously unpredictable and potentially rewarding as investments, it sometimes makes perfect sense to sell some of your previously best loved ideas for more attractive ones or even for cash if the risk/reward equation has changed.

We were negatively affected by quickly rising interest rates, but a more significant factor was my misjudgment of a few companies and their management teams, who for two years told a very attractive story about their companies while reality proved to be much less so during the year. Part of our strong results in 2020 and 2021 was due to positive contributions from these companies, and now there was a reversal for them in 2022. Adjustments to my selection process were introduced during the year to avoid similar misjudgments in the future. I believe these changes have already made River Oak significantly stronger.

Charlie Munger recently said something I have found to be deeply true, '*You get good judgment gradually over time partly by making bad judgments and, importantly, having them work out poorly.*' In fact, bad decisions that work out well are the most dangerous because they fool you into believing you made a good decision. The key is to never make decisions that can kill you.

I don't think all subpar decisions were realistically avoidable. Yes, I was wrong about a few companies, but that happens every year. Another issue was our lack of balanced exposure towards different *possible* outcomes in world events. It became clear to me during the year that we should have a portfolio that better balances the range of possible outcomes than we had when we entered the year – as we did in our early years – but a combination of my natural inclination towards software and online-based companies along with a lack of investment experience that spans decades caused our portfolio to be overly vulnerable to the outcomes that materialized in 2022.

After reluctantly considering this early in the year, I implemented meaningful changes to our portfolio composition in the second half of the year, which included selling some investments where I realized I was wrong and making new investments in the following categories:

- companies in the energy sector that help Europe transition away from a high dependency on fossil fuels and towards greener energy solutions,
- companies I believe will do well (or at least less poorly) in a higher interest rate environment counterbalanced by companies that will have a tailwind in a lower interest rate environment,
- software and online-based companies which became available at significantly lower prices than in recent years,
- companies where a specific corporate event may unlock value, such as for example a spinoff or an announced acquisition where shares trade at a discount to the agreed acquisition price.

The purpose is to minimize the risk of all our holdings being sharply marked down at the same time. Sometimes you hear investors talk about how great large drawdowns are because it gives them the opportunity to buy into their favorite ideas cheaply. While that may be true if you happened to have a large cash balance on the sidelines, believe me when I say that there are generally very few benefits when all your holdings go down a lot at the same time.

While some of these categories are new or new old for us, our selection criteria are unchanged. Our investments are always selected on a bottom-up basis, based on individual merits and their attractiveness relative to all our other available alternatives.

To summarize: a flaw in River Oak's strategy was exposed and needed adjustment. I expect more adjustments to be necessary over the years. Strategy choices that once seemed wise will have to be adjusted and, in some cases, scrapped altogether. To have a chance to reach our goal – an average annual investment return of 15% over River Oak's life – we must have an open mind, a questioning mindset, and always be ready to adjust our sails.

I am certain the past year will prove to be our most valuable so far in terms of our future. Tough times force you to dig deep and evaluate everything you are doing. It is often the truly tough times that give birth to the deepest and most useful insights.

## Interest rate effects

### River Oak specific

When the year began, central bank interest rates in Western economies were close to 0%. At the end of the year, the interest rate in the United States had been raised to over 4% and in Europe to 2.5%. This impacts us in a few ways.

Our tax rate on investments is dependent on the Swedish Riksbank policy rate and will now go up from 0.4% on our capital base per year to 0.9% in 2023. While the increase may seem high at first glance, this is the only tax we pay with our current setup. We do not pay any capital gains taxes except when we receive dividends from foreign companies.

Two factors will offset the tax rate increase to some extent, and possibly more than offset it in some years.

First, we now earn interest on any cash we hold. At the start of the year we earned 2%, and since early March we earn 2.5%.

Second, and unrelated to interest rates, we recently secured a SEK 10 million credit line on good terms at a rate ranging from 1% to 4% depending on how much of the credit we use. It is very flexible and can be used as we want and need, or not used at all. Our total borrowed amount will seldom be above 5% and will never exceed 10% of our total assets.

**General effects**

Higher interest rates affect the value of virtually all financial assets that generate a stream of cash flows in two primary ways. To explain why at a high level, I will assume that we went from 0% interest rate on U.S. Treasury bills, which I refer to here as risk-free[1], to 5%. In the interest of brevity, I also made a few other simplifications.

1. Higher interest rates reduce today's value, the so-called 'present value', of future cash flows. As such, the value of companies that generate them is reduced as well.

   If we knew that interest rates would stay at 0% forever, the present value of one dollar would be the same if you have it today or if you received it in five years or in 50 years since there is no interest to be earned on that dollar. Today however, it is more valuable to have cash on which you can earn 5%. In fact, at 5% annually, you will double your money in 14 years. Accordingly, it is *less* valuable to receive cash in the future since it will not earn you 5% until you have received it.

2. An increase in the risk-free interest rate raises the return requirement on investments *with risk*.

   In short, the return requirement has now been raised from 'more than 0%' to 'more than 5%'. It is therefore no longer attractive to make investments that yield say 2% (think a no-growth company with a Price-to-Free cash flow ratio of 50) which it was when the risk-free rate was 0%. The intelligent investor now wants a return that exceeds 5% (Price-to-Free cash flow ratio below 20) in investments that involve risk – why take risk to earn 5% when you can get it risk-free? – and so the valuation of all assets is adjusted to reflect this new reality.

In the real world it's not as simple, but what you should take away is that most financial assets become less valuable in a higher interest rate environment.

[1] Lending money to the U.S. government is as close to risk-free as we can get in this world, so the interest which the U.S. government pays on Treasury bills is therefore referred to here, somewhat simplified, as risk-free.

## A word on our book value per share

Most of you know me well, and you know that I don't like the big difference that has accumulated between our investment return and our book value per share increase. Three factors have caused it: taxes, operating costs, and the dividend on the class A shares.

I can't do much about our tax rate which will now go up. It is set every November for the following year, and no one (including the Riksbank Governor) knows where it will end up in the coming years. If the policy rate was to be raised further to say 4%, our tax rate for the following year would go up to 1.5% on our total capital base. We will then need to achieve an average annual return above 5% for our current tax setup to remain favorable to us[2]. This will be monitored but given our historical results, we are likely to remain with our current setup under most scenarios.

Even though our operating costs are very low, they still impact our book value to some extent, and they had a much larger impact in our early years. This is not due to any lavish spending but to our still relatively small size, and since I don't want to spend much time trying to increase our size quickly other than by generating good results, we may be stuck with some drag from our operating costs for a while yet.

Finally, there will be no dividend on the A shares until we reach our previous book value high point of SEK 296 per share, so this factor will be narrowing the difference for some time now. As we hopefully get closer to reaching our previous high point, I have let the board know that I think the criteria for this dividend should be reviewed and potentially adjusted.

All in all, while I don't have the faintest idea where interest rates and thus our tax rate will end up over time, I believe that the other two factors, our operating costs and the dividend on the A shares, will contribute to narrowing the gap meaningfully over time.

## Strategy overview

In January, I was invited to Bolzano in the north of Italy by my friend Alexander Pichler (more on Alex later). While there, I presented River Oak's strategy which gave me the opportunity to clarify my thoughts on this subject more than I usually do, so I thought a summary here would be useful.

### Where to invest?

Most importantly, I want to invest in companies that help move the world forward and which empower their customers to live better lives.

[2] The tax rate on Swedish investment accounts is calculated as follows: (Riksbank policy rate on Nov 30$^{th}$ + 1%) x 0.3

At a 4% policy rate, our tax rate would be (4% + 1%) x 0.3 = 1.5% on our total capital base.

Our alternative is to instead pay the capital gains tax rate of 30% on our total profits, which at a 4% policy rate would be unfavorable to us if our achieved average annual return remains above 5%.

If I were to start over from scratch today, I would start by building a mental map of the current state of the world and identify a few large powerful trends that I believe are a net positive for the world. Some examples of such trends over the past decade would include:

- Transition from locally installed (often called “on-premises”) to cloud software
- Smartphones
- Ecommerce
- Electric cars
- Online banking
- Transition towards greener and more efficient energy/heating solutions
- Europe attaining energy independence from Russian fossil fuels

Within each of these trends, there are hundreds if not thousands of companies available to invest in. For example, when it comes to the transition from on-premises software to cloud based solutions, essentially every software company in the world has been transitioning in the past decade.

The idea here is to enjoy the market tailwind of 6-10% returns per year *and* to focus on the parts of the market that grow faster than the average and are likely to keep doing so.

**Moats**

Being in the right place is not enough. High growth and profitability always attract competition. Lots of it. If a company sells a true commodity which is easily replicable by its competitors, its profit margin will, slowly or quickly, but surely, go towards zero over time. These companies are vulnerable even to the smallest of headwinds.

The way out of this is to build products and services which are not easily replicable. In other words: create competitive advantages. There are in my view two essential qualities, which sometimes go hand-in-hand, that strong and enduring companies always have: competitive advantages and a good distribution system.

Competitive advantages, often referred to as ‘moats’ since they protect companies from competition in the same way as moats protect the castle they’re surrounding, can exist in many forms.

One of the strongest moats a company can have is ‘Network effects.’ When a company has a large enough network of users, the network will at some point start expanding like a self-playing piano. People will use it simply because “everyone else is using it”. At a certain size, it becomes almost impossible for competitors to make any inroads. The moat will swallow them all.

Another type of moat that a company can have is a ‘Low-cost advantage.’ When a company has a different way of producing or selling its products at a lower cost than its competitors, it gives the company the ability to offer an equal-value product at a lower price or a higher-value product at the same price. Over time, if the advantage is truly enduring, it often becomes a higher-value product at a lower price.

Let's look at the selling part of the low-cost advantage. Good distribution is one of the most important components of a successful business. Without it, a company's greatness will simply never be known to a large audience.

Most good companies are able to get their products to market at a reasonable cost and run with low enough corporate costs to be able to turn a profit. The differentiator that separates the great from the good is oftentimes efficient distribution. Ideally, a company's distribution system should be inherent within the business model itself and product development should be done with this distribution system top of mind. If a company has built a product that is very easy for customers to work with – ideally, if customers can build a good business for themselves by working with and selling the company's products, the company will have created a highly motivated salesforce that work for them for free.

One of our investments that exemplify all the above is Fortnox. It has a whole collection of moats surrounding its products: a vast network of users which continuously expands and enables low pricing, high switching costs with little to no gain for switchers, and a difficult-to-replicate company culture of easygoing excellence.

Best of all: its most frequent users, Sweden's large and small accounting firms, sell its products for them as they are onboarding customers in their own businesses. In turn, the accounting firms end customers, Sweden's small and medium-sized companies, get business-critical software that every accountant knows how to use at a very low price. Customers win, end users win, and Fortnox wins. It's no coincidence that Fortnox annual marketing budget basically consists of maintenance of their two humble minivans that go around Sweden and host workshops. Fortnox distribution system is a piece of business brilliance.

Our investments are focused on companies that have at least one of these qualities and ideally several of them. More and more of our investments are in companies whose customers and users do much of the distribution for them.

**Portfolio composition**

If there is one thing our Fortnox investment has taught me over the years, it is that most companies do not perform like it. For some context, I initially invested through my family office in 2015 (River Oak didn't exist then) at a price equivalent to a total enterprise value for all of Fortnox of around SEK 750 million. This year or next, Fortnox is likely to report *annual operating earnings* exceeding that number.

I consider this a strong argument for avoiding investments in companies that require world-class business performance over the coming few years to justify their market price. Most companies are simply not up to the task.

Some companies will defy the odds however, and they then often become some of the most meaningful companies we have – and as a result, make for the absolute best investments as well. Thus, I strive to have two types of companies in our portfolio:

1. Companies that I believe can add returns of between 5-30% at the *portfolio* level. These are typically found within the large powerful trends I listed above.

2. Companies that provide balance to the first group where I see little risk of capital loss and that I believe can add returns of between 5-20% annually at the *individual* level.

As an example, Fortnox has gone from being in the first group to now being in the latter in terms of how I think about it. It happens of course that companies in one group sometimes end up in the other.

### What we don't do

It's important to me that you have a good understanding of what River Oak does. It is equally important to me that you have a good understanding of what we don't do.

One certain way to improve our results would have been to invest in companies with no regard to whether they help their customers or harm them. As you know, we do not invest in companies that I believe are a net negative to society, typically those that sell products that are both harmful and addictive. An example here is companies in the gambling industry (yes, that includes a certain large Swedish company starting with an 'E' that I've been asked about many times over the years). Other examples include lotteries, tobacco companies, and gun manufacturers.

I want to be able to look my kids – and you – in the eye and say that I'm proud of the investments we have made over the years. This is impossible for me to say about companies that help gambling addicts or smokers destroy their lives while their shareholders benefit enormously from it. I will much rather report a lesser result than invest in such companies. Some investors do it under the guise of being 'value investors' because of the bargain they're supposedly getting. A more accurate description in my view is that they are investors who will happily do anything for money. To be clear, I don't object to others investing in these companies if they feel good about it. I'm only saying that River Oak will never do it.

As an aside, we don't make investments in other investment companies. While I believe many of them do provide a great service to society, you absolutely do not need River Oak's extra layer of taxes and costs for doing that. If you're interested in diversifying into other investment companies, feel free to let me know and I'll be happy to give you a list of good alternatives.

## Our investments

### New beginnings

Last year showed investors how dangerous it can be to extrapolate. It works fine in most years – until it doesn't. As Howard Marks says, it doesn't work when it really matters.

In 2022, you needed your analysis to be correct, and your companies needed real staying power. It was no longer enough to throw the dart and wait for points to be collected. The dart board had more fields now, there were fields with negative points, and you could miss the board altogether. The darts didn't automatically jump back to the middle anymore.

Yours truly participated in the extrapolation exercise with at least one of our holdings, but we weren't hurt by the 'lose lots of money today to make a lot tomorrow' companies which were the most sharply re-rated as the tide turned. Most good companies I know of were profitable at a very early stage – the truly good ones often can't help it – so when a company does $100 million or even $1 billion in sales and claims more scale is needed to achieve profitability or that going after more market share eats up all profits, I was always cautious.

Investing in evergreen growth is often based on the two popular metrics 'Customer acquisition cost' and 'Customer lifetime value', often referred to in combination as the CAC-to-LTV ratio. CAC is straightforward to calculate since you know well how much you have spent on marketing per new customer acquired. LTV is a pure guessing game however since you have no idea how long customers will stay with you, especially if you're a relatively young company. It often seems to involve a lot of assumptions along the lines that everything will continue as before, which can become a very unpleasant surprise when it doesn't.

There are exceptions, when reinvesting every single dollar of profit and then some into gaining more market share, is a perfectly sound business decision. It is not the rule, however, which has been the going theme over the past few years.

Many of these companies are now suddenly focused on profitability, with the main reason seemingly being because *investors* are now more focused on profitability. At River Oak, we will always prefer companies that walk their own path and make decisions independent of currently prevailing market sentiments.

**Software & Online-based companies**

Why keep investing in software companies you might ask. Was Daniel on another planet in 2022?

Many of the strongest moats in the world today exist in companies who earned their keeps due to software. Even Apple, Amazon, and Tesla, who many would not label as software companies have huge software components that enable their businesses and have helped establish powerful moats. I'd bet a lot that you wouldn't be using your iPhone if there was no AppStore and you weren't able to access Spotify, WhatsApp, or whatever other apps you are using on a daily basis if there were alternative smartphones where you could.

Furthermore, good software companies are inherently very profitable at the core due to their low investment needs. In the past few years however, many of them got caught up in a hiring craze and as a result became less profitable, and in some cases even unprofitable. Not only did many companies hire a ton of new employees but because everyone else in the sector was hiring too, employees had to be paid very well. The resulting increase in stock-based compensation over the past few years has gone to such extreme levels at some public companies that you can almost call them non-profits (this has largely been isolated to technology companies in the United States and has not spread to the Nordics to any large extent).

When I think about some technology companies and their products, and seeing how well Twitter is working with only 25% or so of their previous workforce, it's hard not to wonder what all employees at other similar companies are doing on a regular day at the office. When WhatsApp was acquired by Facebook in 2014, its service was being used by more than 400 million users. WhatsApp's number of employees at the time? 55.

One company that serves as a good example here is Atlassian. Atlassian offers a suite of popular collaboration software such as Jira, Trello, and Bitbucket. I have long viewed it as Fortnox global big brother since it has a similar product offering with a few core products along with many potential add-ons which its users tend to add over time – all of which are readily available and easy to purchase online, which in turn enables a minimal sales team and attractive economics. Its products also have similar attractive characteristics in terms of network effects and high switching costs.

All in all, it should have a similar margin profile as Fortnox. Alas, Atlassian is just about breakeven. Why? I believe they hired too many people at a too fast pace, and in addition they give out stock-based compensation in such high amounts that it eats up all their margin. While stock-based compensation is not cash that goes out the door, it is newly issued shares that go out the door making current shareholders' ownership less valuable as they now own a smaller piece of the company.

Now, once you stop the bleeding, which in these cases mean you stop hiring hundreds and even thousands of new employees that you don't really need to run your business in a good way, high profitability should come back quickly.

Of course, most things that seem crazy stop at some point. As many companies share prices got hammered last year and signs of a slower economy emerged, the hiring spree has lately been reversing as management teams are realizing the beauty of efficiency and focus. I believe we will see more in this direction which should lead to the emergence of a decent amount of highly profitable software and online-based companies, many of whom carry very attractive characteristics, and some of which have been available at attractive prices over the past half year.

Given the quality of companies and strong business models that exist in this category, we will likely always be relatively "heavy" here.

**Energy**

One of our categories that deserves some mention is energy. In the 1970s, which was the last time inflation ran as high as now, energy companies did very well. Energy is one big component of inflation after all, and the higher costs you're paying ends up going somewhere. Today, we have a few additional drivers too: Europe aiming to become independent from Russian fossil fuels, and the worldwide goal of reducing greenhouse gas emissions to the largest extent possible.

Since most people are not prepared to reduce their living standards to achieve these goals, we will need to use energy more efficiently which opens large opportunities for companies besides pure energy producers too.

We are likely to see large investments in transitioning Europe out of fossil fuel dependence and towards greener and more efficient energy solutions for years to come. I use the word 'greener' because most smart energy solutions are not fully green. As an example, while heat pumps increase the efficiency for heating by a few turns, they still need electricity to run. Electricity generation in for example Sweden has for a long time been very green due to our enviable combination of nuclear and hydro power, but this is not the case at all in southern and eastern Europe.

Whether I will find many companies in the energy sector to invest in remains to be seen. Most things in the energy sector tend to be commoditized. Not only are the products themselves often commoditized but demand for them is often dependent on commodity prices as well, which are inherently unpredictable. Thus, I demand a very large margin of safety in all investments I consider in this category.

As always, River Oak primarily focuses on the companies that provide one or more parts of the necessary infrastructure that help make these big shifts happen, ideally those that bring something unique to the table and that have one or more of the moats I described above.

**The Doghouse**

We sold out of both Sinch and Qt Group completely last summer. All in all, these two investments combined produced an almost exact break-even result for us over our holding period (Qt with a relatively large profit and Sinch with a loss). An unfortunate outcome, but not too bad considering I was wrong about both.

I covered my thoughts on Sinch last summer to which I will only add that the CEO was indeed replaced shortly thereafter and the new one, who is also a cofounder, is an enormous improvement in terms of how well he understands the business. That said, my overall view from last summer is largely unchanged.

One clarification: in that same note, I expressed myself a bit too harsh when I said that we will never again invest in companies that report Adjusted EBITDA. The companies we will not touch are those which report it as their primary profit measure and keep labeling clearly recurring costs as "one-time" costs year after year.

When it comes to Qt Group, some of you may remember the good impression Qt's CEO gave many of us at River Oak's annual meeting two years ago. Unfortunately, my previous positive view of Qt seems to have been a serious misjudgment. While their core product, the Qt development studio and its related tools, is helping a decent number of companies out there, I believe most of their reported growth over the past few years is mainly (if not only) due to significant price increases and interesting accounting choices.

Reference calls with customers have indicated price increases in the range of 40% to 150% over the past few years. Qt is also the first software company I can ever recall seeing report *negative* free cash flow (€5 million in 2022) in a year when their reported pretax earnings were significantly positive (€37 million in 2022). It is usually the other way around since most software companies get paid for the subscriptions they sell in advance. In the case of for example a 1-year subscription, customers usually pay the full amount at the start and revenue is then recognized evenly distributed over the coming twelve months. It follows then that in a healthy software company that practices proper accounting, you will have received more cash from customers than the revenue you report, leading to strong cash flow. You can normally see this difference in the 'Deferred revenue' line on the balance sheet.

In 2022, the company paid out essentially all free cash flow they had generated as a public company since their 2016 IPO up until the end of 2021 to key personnel in what was labeled as 'Settlement of share-based payment'. Suffice it to say that Qt has been doing things a bit differently than what I like to see. There is some chance that there is only smoke and no fire here. It would be very easy for the company to alleviate any concerns by disclosing either the number of paying customers they have today compared to three years ago, the magnitude of their recent price increases when they went to a full subscription model, and whether any related accounting changes has affected reported growth or not. I'd be happy to stand corrected if they did.

If a company is intentionally trying to hide something, it is very difficult for outsiders to find out. There are many examples where even the insiders such as auditors often miss the crucial things. As a recent case in point, KPMG signed off without remarks on their audit of Silicon Valley Bank, one of the 20 largest banks in the United States, on Feb 24th. Fourteen days later, regulators had seized the then failed bank and customer deposits of some $160 billion were at risk until the government decided to step in to protect all depositors.

For us as outside investors, the only way to handle this is to always make sure that we truly trust the people in charge. If I have even the slightest doubt, there will be no investment. While this is nothing new, I have put more focus here over the past year and added a few filters that will help me spot potential issues earlier.

Next time I'm wrong, can I wait for the share prices to potentially recover a bit before I sell our position? If I suspect or have confirmed dishonest practices of any kind, I simply don't play. I have had some experiences with dishonest people and even one is more than enough. This policy can occasionally be costly, but it's a very easy decision for me.

Okay, on to more cheerful subjects!

**Writing about our investments**

I have on occasions written a letter or provided you with an update, only to find my own words online in other places shortly thereafter. I can't do much about this, and it doesn't really hurt us much either. Investing is a competitive business, and I don't want our investments to be used in the same way however, especially when it comes to smaller Nordic companies. On a couple occasions, I have even had fund managers who track trading volumes in certain stocks contact me and ask if River Oak is currently buying or selling. While I would of course never comment on that, I'd prefer not having to deal with such questions at all.

Furthermore, these letters were never intended to be stock picking letters of any kind but to be useful for shareholders, and if anything to others, to be along the lines of 'give a man a fish and you feed him for a day; teach a man to fish and you feed him for a lifetime'.

Going forward, I will talk about our investments in terms of themes and important principles rather than specific companies in these letters unless I believe it can meaningfully help the investee company or us in some shape or form. If you are a shareholder and want to discuss our investments, you can of course always call or visit me at the office.

I will also not write about new companies for the sake of proving that I'm generating a constant flow of new good investment ideas. I don't. During some periods I don't find a new really good idea for months and even years, as was the case from mid-2020 to mid-2022. Our practice is in sharp contrast to many other investment firms who often feel it's their duty to present at least some attractive pitches in every quarterly or even monthly update. Oftentimes, this means providing shallow commentary on recent results and trends, and whether those beat expectations or not – information that should be completely irrelevant to the serious business owner – but which keeps wasting an enormous amount of brain power and ink on paper year after year in the investment industry.

Idea draughts are bound to happen from time to time, as they should to all serious investment firms who prioritize strong results rather than "strong" assets under management. While many firms are forced to be in the latter camp due to structural reasons, River Oak will stay firmly in the former.

## In closing

If you have ever competed in elite sports – being wrong on an investment in which you have put a significant amount of effort feels eerily similar to losing a championship finals match. It's overwhelming disappointment for a day or two before motivation to improve takes over.

Can you guess who leads the All-time list for *missed* shots in the NBA? This same person also shot four air balls at the end of a crucial game which eliminated the Los Angeles Lakers from the playoffs in 1997. Kobe Bryant. If Kobe Bryant can shoot multiple airballs on the world stage in the final minutes of a crucial playoff game and then come back to win five championships, we should be able to recover from a few bad investments. Indeed, I believe you'll be far better off over a lifetime if you dare to try learning new things and take game-winning shots rather than always hide in the safety of the shadows. The crucial thing is to always keep improving. If you come back and keep shooting airballs year after year, you have a real problem and you probably shouldn't be playing at the highest level.

After our first year of negative returns, I believe we now have a more solid footing than ever before. I don't think this would have happened were it not for how 2022 developed.

Looking to the future, as you know, I don't spend my time trying to predict where inflation and interest rates are going, how the war is going to end, whether the world will see a serious recession, etc., other than to have an overall view of current events. I believe my time is much better spent on individual companies, and I believe this focus will give us the best possible chance to achieve our goals and attain good results.

It is very important to me however that you define good results like I and our board define it. River Oak's ultimate long-term goal is not to avoid all down years but to achieve long-term results that make a difference in your life. Protecting the downside helps us a lot in this endeavor. Hence, not losing money overall is one of our two explicit goals, while the other is to earn an average annual investment return of 15% over River Oak's life. Yes, it is correct that the latter is hard to achieve without the former.

Please make sure that you will be happy with your River Oak investment at the end of five or ten years if we achieve these goals. You should note that the often touted 10% annual returns the public markets have provided *on average* over the past 100 years or so (including by some guy named Daniel) have not held up in all periods. You need to consider the risk that markets can have a rough decade.

I'd like to end with a keen welcome and some thanks.

First, we will have a new board member up for election at our annual meeting. Alexander Pichler, who is the CEO of DELMO, a privately owned Italian investment firm with a focus on public equities that also has a joint venture in real estate development. In his youth, Alex spent some time at McKinsey (ouch!) before joining the family business and leading its transformation over the years. He has been in business for 20 years and will bring some well-needed experience to our board. I look forward to it. Welcome, Alex!

I'd also like to thank our current board who stood steady during the past two years when the wind sometimes blew hard in our face. One of our current board members, Arimatti Alhanko, will not stand for re-election this year as he will focus fully on his recently started fund. Thank you, Ari, for these two years and I wish you the best of luck.

Our annual meeting will be held on April 29th. Please note the new date. An invitation and details will be sent out shortly. The board and I look forward to seeing you there.

Finally, as a shareholder you are part of a humbling group of people. We have everything from doctors and professors to software developers, management consultants and investment professionals to entrepreneurs, business owners and CEOs. During the year, while I'm sure some of you were disappointed with some of my decisions, I didn't receive a single call or note telling me how stupid I was but only a few friendly questions along with some helpful pointers. It's almost to the point that I encourage you to send some of the former as well (before you start typing, I said *almost*). This was truly helpful as the events of last year required a lot of focused effort. Your calm behavior allowed me to focus on the job without any distractions. Thank you for your trust and patience during this period. I know it wasn't always easy. I will keep doing everything I can to make sure it counts.

March 23, 2023

Daniel Glaser
Chief Executive Officer

## Founding principles

Our basic idea is simple:

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

   Human progress is the reason why stock markets have historically produced average annual returns of 6% to 10% over the past 200 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%+ average annual returns the general market has provided and is likely to keep providing investors over time.

## Goals

1. **Don’t lose money.**

   We always think about the downside first. While we will inevitably lose money on some investments, this goal is about not losing money overall.

2. **Earn an average annual investment return of 15% over time.**

   This will result in an average annual pretax increase in book value per share of ~11.5% after a dividend on the A-shares according to the Company’s Articles of Association and general operating costs.

## Historical returns

Feb 7, 2017 – Dec 31, 2022: River Oak Capital AB
Jan 1, 2013 – Feb 6, 2017: Zen Capital Family office

| | Investment return (pretax) | Net result | OMXS30 incl. div. (pretax) | Difference |
|---|---|---|---|---|
| **2013** | 41.0% | **30.8%** | 25.5% | 5.3% |
| **2014** | 45.0% | **33.8%** | 14.0% | 19.8% |
| **2015** | 35.1% | **26.3%** | 2.2% | 24.1% |
| **2016** | 20.5% | **15.4%** | 9.4% | 6.0% |
| **2017** | 19.6% | **14.0%** | 7.7% | 6.3% |
| **2018** | 0.0% | **(6.0)%** | (7.0)% | 1.0% |
| **2019** | 61.7% | **50.1%** | 30.7% | 19.4% |
| **2020** | 104.0% | **74.3%** | 7.4% | 66.9% |
| **2021** | 14.3% | **10.8%** | 32.7% | (21.9)% |
| **2022** | (26.9)% | **(28.8)%** | (13.0)% | (15.8)% |
| | | | | |
| **Total gain** | 997.6% | **464.0%** | 159.7% | 304.3% |
| **Compounded annual gain** | 27.1% | **18.9%** | 10.0% | 8.9% |

**Notes to table**

[1] Change in Book value per share is reported net of a dividend on class A shares according to the Company's Articles of Association, taxes, and general operating costs. There is no dividend on the class A shares unless the yearend book value per share is higher than all previously reported years. For more details, see the Company's Articles of Association.

[2] The OMXS30 incl. div. column does not include the standard annual tax payment on Swedish investment accounts which amounts to between 0.4% to 0.5% of total capital per year and which River Oak pays every year. The real return achieved by a Swedish investor that invested in the index is thus between 0.4% to 0.5% lower per year than reported in the table, and the real difference achieved by the same investor is between 0.4% to 0.5% higher per year than reported in the table.

[3] Estimated currency effects on Investment return: 2014 +7%, 2016 +2%, 2017 -10%; 2018 +5%, 2019 +3%, 2020 -6%, years not mentioned <2%. River Oak does not in any way strive to foresee or profit from currency movements. Our belief is that any impact from currency movements will be negligible over time.