River Oak Capital

Streamsong, Dec 2017

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Background

- Investor since 2010, small business owner since 2013
- Fiancée & two kids (4 yo & 1 yo)
- Former athlete, Swedish National Team in Badminton 1992-2006
- M.Sc. Engineering Physics; Specialization in Optimization Theory
- Master's Thesis: Fluence Map Optimization for Cancer Radiation Treatment Planning at University of Gainesville, Florida

  => My supervisor founded ViewRay, Inc. in 2006; listed on Nasdaq in 2016

Why investments?

- Asked my boss if he knew how to value companies. His answer: Compare P/Es.
- I thought some more about it, read Snowball & Security Analysis, 2 years later a friend asked for my help valuing a special situation company, I got hooked.
- Had other tempting offers:
  *ViewRay, Inc.
  *Karolinska Institutet
  *Family-owned business Nutris
- On all vacations and spare time I was reading about companies and investments.
- 10x better result if you do something that truly fascinates you.
- Had doubts quitting all help-people-with-their-health projects – Interview Jeff Bezos on why he spent a lot of time and billions on Blue Origin:

”You don't choose your passions. Your passions choose you.”

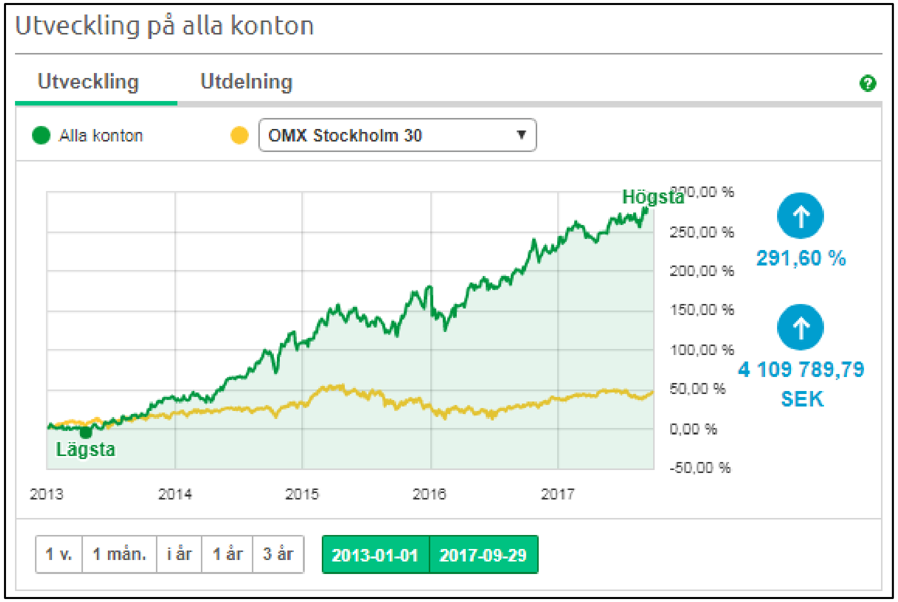
River Oak Capital

- River Oak Capital AB started operations in Feb 2017.

  Structured as investment company, 11 initial shareholders, will be close to 20 shareholders after Nov 2017 equity raise.

- Jan 1, 2013 – Feb 7, 2017: Zen Capital Family Partnership.
  Feb 8, 2017 – Sept 30, 2017: River Oak Capital AB.

	Gross Return	Partners incl. div.	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%
Sept 30, 2017	19.6%	14.0%	10.6%	3.4%
Total Return	298.1%	190.6%	76.1%	114.5%
Compounded Annual Return	33.8%	25.2%	12.7%	12.5%



* Left: Pretax. Right: Aftertax.
* Currency effects on gross returns positive 7% in 2014, positive 2% in 2016, negative 8% per Sept 30, 2017; other years <1%

Goals

1. Don't lose money – always consider the downside first.

2. Earn 15% (pretax in SEK) on our capital on average per year over time.

   => Book value CAGR ~11% per year after costs (mainly salary).

We are long only

Performance of Financial Assets in America from 1801 to today

Source: Jeremy Siegel, Future for Investors (2005), Bureau of Economic Analysis, Measuring Worth

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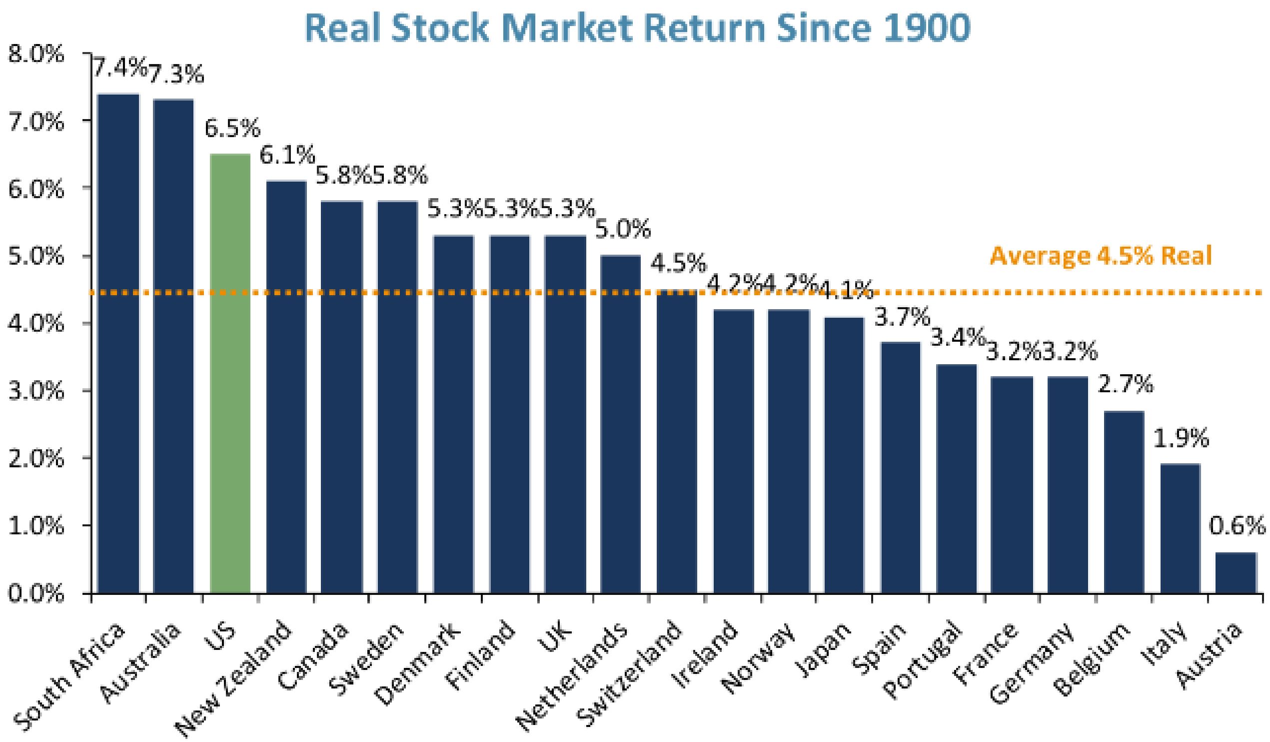
We primarily invest in the Nordic countries and the US

7-10% (nominal) return per annum since 1900 – we're in a very favorable game!



Source: Dimson, Marsh, Staunton, Triumph of the Optimists: 101 Years of Global Investment Returns

We don’t try to predict the market..

- Brilliant analysis of interest rates but wrong about global growth, inflation, China, India, Trump.

  → Useless when trying to predict the market.

- Did anyone here foresee:

1. Low/Negative real interest rates for so long?
2. Oil price?
3. Bitcoin?
4. Brexit? Trump?
5. That stocks would be on 9th up year despite Brexit and Trump?

- ***I know I didn’t predict past five years, and see no reason why I would have better luck with next five.***

However, I did roughly predict the earnings growth of a small number of companies.

WB & CM put in combined ~140 years…

"Microeconomics is what we do. Macroeconomics is what we put up with."

– Charlie Munger

"I never have an opinion on the market because it would not be any good and it might interfere with opinions that are good."

– Warren Buffett

"If Federal Reserve Chair Janet Yellen came up and whispered in my ear what she was going to do for the next two years, it wouldn't make any difference to what we do."

– Warren Buffett

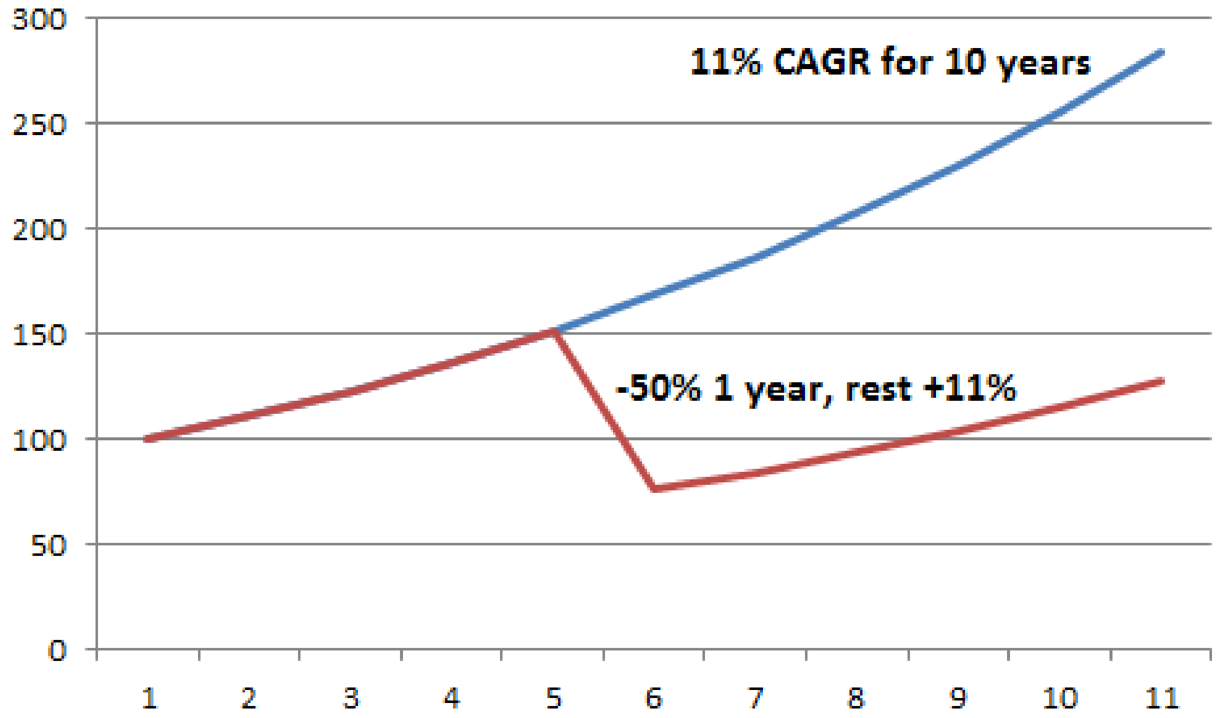
"I think not reading much macro is very beneficial."

– Howard Marks

It’s important to be in the game..

- Can you imagine an elite athlete skipping two years because he/she is worried about injuries?
- Market has been fantastic over past 100 years – but if you’d missed the best 7% of days in the market, your return would have been close to zero.
- One big reason why River Oak is structured as an investment company.

Offense wins games, defense wins championships



High concentration

(5 to 8 holdings, top 5 usually >75% of portfolio)

- If you make decision to be active investor – make sure you get paid if you're right.
- I believe high concentration and few losers are main reasons for our good results so far.
- Portfolio with 30+ stocks becomes almost impossible to know well.
- More than 7-8 stocks does not give meaningful volatility reduction.
  (Source: Concentrated Investing by Allen Benello, Michael van Biema, Tobias Carlisle)

TABLE 4.1 Effect of Diversification

Number of Stocks in Portfolio	Expected Standard Deviation of Annual Portfolio Returns (%)	Ratio of Portfolio Standard Deviation to Standard Deviation of a Single Stock
1	49.24	1.00
2	37.36	0.76
4	29.69	0.60
6	26.64	0.54
8	24.98	0.51
10	23.93	0.49
12	23.20	0.47
14	22.26	0.46
16	21.94	0.45
18	21.20	0.45
20	21.68	0.44
25	21.20	0.43
30	20.87	0.42
40	20.46	0.42
50	20.20	0.41
400	19.29	0.39
500	19.27	0.39
1,000	19.21	0.39
Infinity	19.16	0.39

High concentration

I encourage you to:

1. Take note of your 6 highest conviction ideas at the beginning of next year and decide on appropriate weights.

2. Take note of your 15 highest conviction ideas at the beginning of next year and decide on appropriate weights.

3. At end of the year compare the results.

- Personally I saw a very clear improvement (it's possible you won't).
- I want to own as few holdings as possible but enough to sleep like a ~~baby~~ teenager.
- A potential downside to high concentration is a black swan event in one of your largest holdings, harder to keep your poise when it's a 20% position than a 5% position.

What companies do we look for?

Before putting in >5 minutes I want to roughly understand the business right away.
If I don't, one month of studying usually won't help (enough to get high conviction).

1. Companies with competitive advantage that I understand well.

2. Companies with solid base to survive downturn – balance sheet and business model.

3. Companies that I believe will make more money in the future than they do today.

4. Attractive price.

5. Honest, capable and competent management.

   Prefer if management owns enough stock to make a difference in their lives if all goes well – running a business is tough and sometimes grueling – you need to have a management that really cares.

* Exceptions can be made, think it's a bad idea to religiously try to fit all your holdings into the same checklist.

In particular we like:

- Software & Online based businesses
- Business services
- Market leadership in niche market
- Cost of product/service small in relation to customer’s total costs
- Low ARPU, prefer many customers
- Simple companies – want to be able to understand main drivers/risks well

  (Focus is always on the big picture, don’t spend much time diving into details.)

How do we value a company?

- Estimate cash flow and net assets in 2-4 years.
  (usually back-of-the-envelope, no advanced models in any way)

- Multiple based on business model, competitive position, growth runway, predictability of cash flow.

- *Investing is as much art as science.*

- *You don’t need to know a man’s height to know he is tall.*

How do we select?

- Want to see a healthy FCF today or a couple of years hence. FCF doesn't need to show up in reported numbers (e.g. Amazon) if I know it's re-invested well in the business.

- If two companies are hard to separate and promise similar return we always lean towards the more careful choice.

- Always prefer to be very sure of 10-25% annual return than possibility of 50-100% return where I’m not sure at all.

- ***Key question: “How sure are you?"***

FIAT

Investment in 2014:

- Fiat had just acquired last part of Chrysler; owned Jeep, RAM, Ferrari, Maserati, etc.
- Best CEO in the car business Sergio Marchionne
- Pentup demand after financial crisis, average age of cars highest ever (deemed big SAAR downturn unlikely)
- Initial thesis: Fiat to be valued more in line with GM, Ford plus Fiat had Ferrari & Marchionne
- Thesis evolved: Jeep, 5-year plan became bigger factors
- Paid: 15B plus 10B debt
- Today: 50B, almost no debt (Ferrari spun off)

FORTNOX

Småföretagens bästa vän

Investment in 2015:

- Fortnox 2014 Annual Report:

  "Only 15% of large companies and 11% of small companies buy cloud services for accounting and financial control. The most common reason is lack of knowledge, SCB's survey shows."

- Fortnox had ~100k customers, 1M companies in Sweden whereof 99% are small companies making them ideal for Fortnox.
- Very strong network effect and switching cost
- Many add-on modules → believed ARPU would grow
- Paid: ~8x my 2018E EBT
- Today: ~25x my 2018E EBT

Be different

- ***To get better than average results you need to do something different than the average.***

- At any given time, ask yourself:
1. Is my portfolio really unique?
2. Is it a reflection of my interests and ideas?
3. Do I truly have any insights about these companies and its future that many people don't agree with or see yet?

- Our biggest winners over past 5y have been ideas where I came up with the thesis pretty much from scratch (opposite would be to regularly invest in something like Sohn Conference ideas).

- ***Being yourself goes a very long way towards being different.***

- If you know anyone that own or has owned both Fortnox and Fiat – please let me know!

Thank you for listening!

River Oak Capital

Contact:
Daniel Glaser, glaser@kth.se, +46 (0)70 496 3114

River Oak Capital AB
Seminariegatan 26
752 28 Uppsala
Sweden