Bonsai Partners

July 14, 2020

Dear investor,

For the three months ended June 30th, 2020, the Bonsai Partners portfolio appreciated 109.8% gross, and 101.8% net of fees and expenses. The S&P 500 total return index returned 20.5% over this same period.

Year-to-date, the portfolio appreciated 63.9% gross, and 57.4% net of fees and expenses, compared to -3.1% for the S&P 500 total return index, as presented below.

At the end of the quarter, our gross exposure was 91.3%, with 8.7% held in cash.

Bonsai Partners Historical Returns Summary

	YTD 2020	**2019**	**2018***	**Since Inception***	**Annualized** *Since Inception*
Bonsai Gross Return	**63.9%**	**60.6%**	**-17.9%**	**113.5%**	**56.6%**
Bonsai Net Return**	**57.4%**	**56.4%**	**-18.1%**	**101.6%**	**51.4%**
S&P 500 Return	-3.1%	31.5%	-8.6%	16.4%	9.4%

The performance data shown above represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment with Bonsai Partners will fluctuate so that an investment, when redeemed, may be worth more or less than its original cost. Performance may be lower or higher than the performance data quoted due to different fee structures, beginning periods, capital additions, or individual mandates.

**Inception Date: 10/22/2018*
***Net Returns apply a 1.0% management fee and 10.0% incentive fee above a 6.0% compounding hurdle*

In last year's Q2 letter I said: "while we had good results this quarter, a ~50% return for any portfolio over a three month time period is unusual, and I don't expect we'll repeat that any time soon." Apparently, I was wrong about that; doubly so.

At the risk of sounding philosophical, I don't view these results as "good" or "bad." They just are. This quarter presented an unusually productive harvest, and we filled our silos with a bumper crop. I have no idea if famine or fortune lurks around the corner, but we're certainly going to stock up while the getting is good. In either case, this good fortune either offers a buffer against future stresses or provides a larger base for growth. I have no idea which.

Our quarterly performance has been quite lumpy since inception, and this quarter practically redefines the term. I expect performance to continue to be uneven as long as we have a concentrated portfolio, but, as the portfolio improves (in terms of idea quality and quantity), there should be less lumpiness.

While last quarter presented an incredible set of challenges, the efforts and actions taken to reposition the portfolio at that time laid the foundation for what we're experiencing today. New positions and additions made to existing positions benefitted the portfolio.

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That said, my execution hasn't been flawless. I made multiple mistakes, big ones. I missed a few large opportunities that I had been closely watching, and in one situation, I sold a position right before it appreciated ~100%. The good news is, none of these mistakes were fatal, and the rational decisions made dwarfed the errors committed.

Notable contributors to performance during the quarter were: Redbubble, Genasys, Pushpay, LKQ, Illumina, and Taiwan Semiconductor. While there were no meaningful detractors of performance this quarter, Travelsky Technologies and MiX Telematics both lagged our benchmark.

I provide a brief commentary on each position in the **Position Update** section below.

At the end of this letter, I share a deeper look at our newest and now second-largest position: **Pushpay**.

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COVID-19 Update

To echo what was said last quarter: I don't know how this pandemic will unfold and I won't make any predictions here.

What is more certain is the coronavirus has created an even wider rift between the physical and digital economy. Even today I find it hard to process that the digital economy is booming while the physical economy is suffering.

It feels like we're experiencing the physical stresses of 2008-2009 and the technological exuberance of 1999-2000 at the same time. Physical businesses are closing en masse, while technology companies are approaching valuations only tested once before.

Our portfolio is overweight the digital economy, and while these companies were thriving before the pandemic, they are now also enjoying a tailwind from the increase in digital transactions.

It's important to note that while we are overweight digital companies, none of our investments are priced at nosebleed valuations; each is anchored by cash flows or a clear pathway to cash flows and self-funded growth.

Regardless of the operating environment, our north star remains the same: I'm looking to invest in **great companies** at **great prices**. To achieve truly outlier investment returns **we have to find both simultaneously**; **one is just not good enough.**

The best defense we have against the unknown is the same criteria mentioned above: **1)** owning great companies: these businesses endure across difficult operating environments and **2)** buying at great prices: reasonable prices insulate us from potential downside.

Our Travelsky position is a real-time case study of what happens when things go wrong: Travelsky is a great business (the monopoly software provider to Chinese airlines) and we purchased our position at an attractive price. Although Travelsky has been deeply impacted by COVID-19 due to its direct exposure to Chinese aviation, our losses have been modest.

The portfolio continues to get better each quarter, both in terms of what you can see (the portfolio itself) and what you cannot (the idea pipeline). I've consistently found that if you want to find **great assets** that are also available at **great prices**, you have to go where others aren't willing to go and do what others aren't willing to do.

Pushpay, a New Zealand based software and payments company is an example of a great business that I was able to acquire this quarter at an attractive price. Few investors are willing to look in New Zealand, let alone in Pushpay's operating niche (selling to the faith sector), and these barriers kept out most investors and allowed us to own the business at a favorable price. Although Pushpay is domiciled in New Zealand (trades on the Australian Stock Exchange), 98% of its revenues are from the United States, and its headquarters is based in Redmond, WA.

I share the investment case for Pushpay in the pages below.

While I know exactly where we're going, I don't precisely know how we'll get there. All I can promise is that I will stay the course and rely on the compass of our mission. The world is full of exciting investment opportunities, and it will take time, patience, and an investigative spirit to find them. For me, that journey is the destination, and I hope to be hunting for the next big idea for as long as I possibly can.

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PORTFOLIO REVIEW

Portfolio Exposure (As of 6/30/2020)

Company:	**Position Size (%):**
Redbubble	*61.4%*
Pushpay	*9.8%*
Travelsky Technology	*6.6%*
LKQ	*5.2%*
Genasys	*2.7%*
Taiwan Semiconductor	*2.6%*
Illumina	*1.9%*
MiX Telematics	*1.2%*
Total Gross Exposure	***91.3%***
Cash	*8.7%*
Total Exposure	**100.0%**

Most likely, you're wondering how or why Redbubble became such a large position. I can assure you this wasn't by design, and if you recall last quarter, I increased the size of the Redbubble position to a very large 30% position. I built a tremendous amount of conviction in the Redbubble business over these past 1½ years of ownership and the very low price it was available for in March was an opportunity I couldn't ignore. Not only was the share price 50% lower, but I believed their business would benefit from the pandemic.

This quarter, Redbubble saw significant share price appreciation, causing the position to balloon into a very large one practically overnight. Having such a large position is not a viable way to run a portfolio of investments over the long run, and I plan on resizing the position accordingly over time.

This concentration issue is a very high-class problem to have, and I intend to use Redbubble as a source of capital for new ideas as they present themselves. Said differently, I do not intend to sell down Redbubble today just for the sake of rebalancing the portfolio. Our portfolio has never been conventional, and I don't intend to follow an arbitrary portfolio management rule just to make the portfolio appear more attractive to potential new investors. As a guide-post, I expect a 20% position to be the upper boundary of where I'd like to go in the future sizing of a very-high conviction position. Our portfolio won't have a position of this size for long, but I will reiterate that portfolio construction will be the **output** of what I can find, **not the input**.

The Redbubble business is very high quality and their future remains bright both in the interim and in the long-term. I intend to maintain this large position until I find new high-quality ideas that can diversify this exposure. This might take a few quarters to accomplish. Until that time, I'm happy owning this well-positioned business in size. I explain the Redbubble situation in more detail below in the **position update** section below.

Aside from Redbubble, I'm pleased to share that we finally hit the point of being close to 100% invested within the quarter. For those reading these letters since inception, you'll know that this was a very important milestone for me, one that took seven quarters to achieve! The bad news is, after reaching this point I sold the rest our of Southwest Airlines position and decided to scale back our large Genasys position due to the significant appreciation we saw in intra-quarter. These actions brought our end of quarter gross exposure down to ~91%, which is still very much a win in my eyes. I am confident we will reach 100% again soon and will maintain that level of positioning in a structural fashion going forward.

Similar to last quarter, I was busy from a portfolio management perspective. We purchased one new investment: Pushpay, and sold two positions: Southwest Airlines, and a previously undisclosed position in Upwork. Finally, as mentioned above, we significantly trimmed our position in Genasys.

While we didn't lose much on the sale of Upwork, that decision looks foolish in hindsight: Upwork's stock appreciated ~100% after I exited the position. I don't sell lightly, but I realized that I didn't have conviction in the business model, and if that's the case, I don't deserve to be an owner of the company. Clearly, I should have held on for a bit longer before selling.

The decision to sell the remnants of the Southwest Airlines position was explained in our last letter, and I redeployed that capital into our new Pushpay position.

Genasys was a different situation. That position was consummated with an expectation of a >100% return over a 3-4 year time frame. Unexpectedly, that result was realized in 3-4 months! Unlike Redbubble, which is now experiencing accelerated underlying business trends, Genasys hasn't seen much fundamental improvement. As a result, the higher share price changed the risk/reward of the investment, especially since their runway is more finite compared to Redbubble's. While I still believe in the Genasys opportunity, the position was too large for the amount of execution risk they now have, and so, I adjusted the position accordingly.

Our portfolio continues to get better through increased diversification of good ideas, rising opportunity costs, and upgrading the quality of the businesses we own. I expect these trends to continue as long as I stay maniacally focused on finding great businesses at great prices.

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POSITION UPDATE

Redbubble (ASX: RBL)

Redbubble is a two-sided marketplace that connects artists to consumers looking for products that express who they are. If you haven't used www.redbubble.com before, I highly recommend it.

Redbubble was a meaningful contributor to performance during the quarter, appreciating ~250%. We significantly added to our position late last quarter as the shares declined.

As mentioned earlier, Redbubble (and e-commerce in general) has been a beneficiary of COVID-19. Since many have avoided shopping in person, this led to significant sales growth across most e-commerce platforms. Both Redbubble, and its sister website: Teepublic, continue to be inundated with orders, with current demand at or above December holiday levels. Redbubble recently reported growth of approximately ~100% year-over-year for the second calendar quarter, compared to their usual growth trajectory of 15% to 30%.

As mentioned earlier, our Redbubble position is unusually large. While it made sense to raise our exposure in Redbubble to a very sizable 30% position given how attractive the shares were in March, the stock appreciated dramatically during the quarter, forming an outsized position practically overnight. This is a high-class problem, and as said above, I intend to meet this portfolio management challenge over the coming quarters as I uncover more good ideas.

The good news for us is Redbubble is an outstanding business and even at these prices the risk/reward remains excellent as the valuation is by no means stretched at these new highs. I'm in no rush to trim the position, and any rebalancing will be dictated by the ideas I'm able to find.

Pushpay (ASX: PPH)

Pushpay is a leading provider of software and generosity solutions for the faith sector.

I outline our investment rationale on Pushpay in the pages below.

Pushpay shares appreciated ~20% from our cost basis during the quarter.

Travelsky Technologies (HKEX: 0696)

Travelsky is the leading provider of software and systems for airlines and airports in China.

Travelsky shares were approximately flat during the quarter.

Chinese air traffic continues to be meaningfully lower in the wake of the pandemic, and if you recall, Travelsky earns a fee for every ticket booked on virtually all Chinese airlines. It's a great 'toll-road' business, but it faces a difficult operating environment in the short to medium term. As of May, Chinese monthly air traffic was approximately -50% lower than it was a year ago, but this looks favorable compared to the near-complete halt experienced around Chinese New Year.

I expect weakness in their operation for a prolonged period (likely continuing through the end of 2021), but despite this, the underlying investment thesis remains sound. Travelsky is a very good company with strong prospects as travelers return to the skies over the next few years. The IRR I expect for the investment is lower than it was when I first purchased the position, but it remains attractive. The business continues to be on solid footing due to its debt-free, cash-heavy balance sheet, and a cash-flowing underlying business. Despite the current challenging conditions, the company is unlikely to burn much cash (if any) this year, keeping them in a reasonably strong position.

LKQ (Nasdaq: LKQ)

LKQ is the largest provider of alternative collision and mechanical automotive parts in the United States. In Europe, they are the leading distributor of general automotive maintenance parts and supplies.

LKQ shares appreciated ~28% during the quarter.

Similar to Travelsky, LKQ is a COVID recovery story. The company indicated that each week since its trough in April their sales have been sequentially improving, albeit at levels still below that of 2019.

LKQ is the only business we own that has a vulnerable balance sheet, so I was pleased that the company was able to renegotiate its debt covenants with lenders during the quarter. This development adds operating flexibility and insulates against potential new challenges. LKQ's covenants were my single largest concern when I invested, so this was a much-welcomed development.

I remain enthusiastic about LKQ because it is a counter-cyclical business that benefits from recession-like conditions if one comes to pass. Further, as COVID makes public transportation a less viable option, private vehicle traffic will see increased usage, benefitting LKQ. As the company gets back on track, it will once again resume its operational improvement plan and go back to reducing its debt.

Genasys (Nasdaq: GNSS)

Genasys is a provider of critical communications solutions for both civilian and government personnel.

Genasys shares appreciated approximately 49% during the quarter. I meaningfully trimmed our position at prices well above those recognized at quarter-end.

From the trough in March through the peak intra-quarter, Genasys shares appreciated >200%. These share price movements did not appear to be driven by improved company fundamentals.

For reasons mentioned earlier, I decided to trim the position near these highs as the forward-looking risk/reward wasn't as attractive and therefore it didn't merit such an outsized position. I retained a smaller position in Genasys as the future remains bright for their emerging software business.

Taiwan Semiconductor (NYSE: TSM)

Taiwan Semiconductor is the world's largest outsourced foundry of semiconductor chips.

Taiwan Semiconductor roughly grew in line with the market: appreciating approximately 20% during the quarter.

While TSMC typically stays out of the limelight, the company was an object of media attention during the quarter due to the U.S.-China trade war. In particular, the Trump administration blocked TSMC from selling chips to its second-largest customer, the Chinese company Huawei.

I won't get too deep into the specifics, but this was a remarkable development considering TSMC is a Taiwanese company with a limited U.S. presence. Fortunately, the market for semiconductor chips is a large and growing one, which led TSMC's management to indicate that they expect to quickly replace Huawei's lost volumes (which represent around 10-15% of sales). I continue to monitor this development.

This recent issue surprisingly highlights part of the rationale behind our TSMC investment – as the leading player in the outsourced foundry market, not having access to TSMC puts even a very large and capable company like Huawei at a significant disadvantage. Taiwan Semiconductor is an increasingly crucial partner for most players in the world of fabless semiconductors.

Illumina (NASDAQ: ILMN)

Illumina is the leading provider of genomic sequencing instruments and reagents.

Illumina appreciated 34% during the quarter.

Despite an unusual operating environment, the quarter was reasonably quiet for Illumina. The company continues to be a vital part of the Life Sciences research industry, and despite temporary disruptions experienced by lab customers this past quarter, Illumina's technology continues to be a key enabler of progress in the field.

MiX Telematics (NYSE: MIXT)

MiX Telematics is a provider of telematics solutions for transportation fleets.

MiX Telematics shares were flat during the quarter.

MiX was a previously unannounced small position in our portfolio last quarter. While their solutions are logical for businesses looking to reduce driver caused accidents and save on fleet fuel costs, an observed increase in competitive threats from highly capitalized/aggressive "start-ups," as well as a dramatic decline in oil prices made the original investment thesis less powerful. This explains why the position remains reasonably small in our portfolio. I continue to monitor the position and its potential.

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New Investment: Pushpay (ASX: PPH)

Some of the most interesting ideas are found by asking why strange things 'are the way they are.'

When something doesn't make sense, it's easy to lose interest and move on. However, those moments should act as red flags that scream out: "drop everything that you're doing and figure out what's happening here!"

Pushpay is one of the fastest-growing software and payment companies in the world, yet their customers are Churches. Yes, Churches.

How is that possible? That makes no sense.

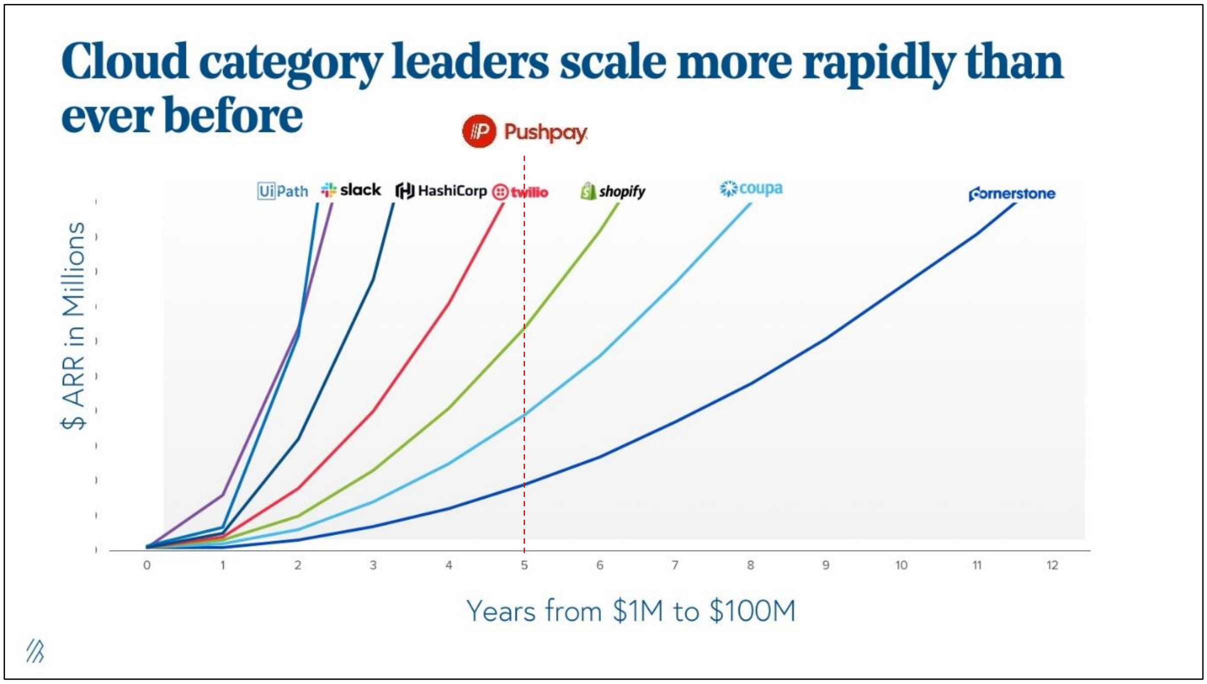
Those who figure out why strange things 'are the way they are' tend to make interesting discoveries when they uncover the answer. That was certainly the case for me with Pushpay.

By going beneath the surface to understand why Pushpay is growing so fast, I was able to see that Pushpay is a great business that trades at an attractive price.

Earlier this year, I was reviewing a list of the fastest-growing companies in the Asia-Pacific region, and Pushpay made the list. Despite my confusion about their rapid growth, I figured that any company growing so quickly must have figured out something interesting. I wanted to know what that was.

Further, in the world of software, scaling from $1 million of recurring revenue to $100 million is considered a quantum leap that few can make. Those companies that do make it to the other side tend to have significant staying power and future growth. In Pushpay's case, the company was founded in 2011, first reached $1 million by mid-2014, and scaled to $100 million by mid-2019; just under five years.

The faster a company scales from $1m to $100m, typically, the stronger their product-market-fit and distribution channels.



Source: Bessemer Venture Partners, State of the Cloud 2020, ***Pushpay Added For Reference Purposes***

The key difference for Pushpay: Most hyper-scaling tech companies burn incredible sums of cash to deliver their rapid growth. Pushpay on the other hand is **cash-flow positive.**

In other words, Pushpay's growth engine is self-sustaining, and its growth is not fueled by other people's money.

Investment Overview

Pushpay is a provider of software and payment solutions for the faith sector. While the business is domiciled in New Zealand and its shares trade on the Australian Stock Exchange, 98% of its revenue is based in the United States, and its headquarters is based in Redmond, WA. Their financials are reported in U.S. dollars as well.

Pushpay is a de-facto U.S. company, but it trades in an unfamiliar geography (where it was founded) which keeps out many investors. Management indicated they intend to list their shares in the United States in the future.

Pushpay's pitch to churches is simple: a minority of their congregation represents the majority of their donations and participation; the 80/20 rule in action. Pushpay offers solutions that help engage the other 80% through digital giving, engagement solutions, and a church management platform. Their 'killer app' is digital giving, which makes generosity easier for those who wish to give.

Typically, church donations are given on a plate that is passed around to attendees who offer envelopes of cash or checks. This process is far from frictionless and it is easy for someone to forget their checkbook or be low on cash that week.

Pushpay’s insight was: if they can make donations as easy as a few clicks on a phone, it would remove this friction, and engage a larger part of the congregation. Pushpay further offers recurring donations that don’t require any weekly action. According to Pushpay, **a digital giver donates 50% more in a given year than a non-digital giver.**

Similarly, by offering custom websites and phone apps, Pushpay helps churches engage a wider part of their congregation. In short, these solutions help churches in a world where most are struggling to retain their congregations.

Most pastors are uncomfortable asking for money, and if a church can collect an additional 10% - 20% in a given year just by adopting Pushpay, it’s an easy win. In exchange for these additional donations, Pushpay charges a 1% fee for all digital donations that flow through their system (in addition to the interchange fees that are passed along to payment processors for ACH, debit, and credit cards). In short, it’s a no brainer to pay an additional ~2.0% to get an additional 10% - 20% more donations.

Surprisingly, this market is quite large. Over $110 billion are donated to churches each year, and it’s estimated that only ~15% of those payments are made digitally today. In the past fiscal year, Pushpay transacted an impressive $5 billion of digital donations.

Over time, more and more donations will be made digitally, and there’s no reason why most donations in the future couldn’t ultimately be digital. Pushpay stands to benefit from this trend as the market leader.

Pushpay’s impressive product, sales team efficiency, profitability, and a long runway for growth translate into a large opportunity for investors.

Expanding the Church Software Opportunity

There are three main technology products sold to the faith sector today:

1. Generosity tools (digital donations)
2. Engagement tools (church website and custom church mobile applications)
3. Church Management software (tools to reach the congregation, manage services, events, etc.)

Historically, Pushpay offered strong generosity and engagement tools but did not have a Church Management platform (known as ChMS).

While most industry profit will come from generosity solutions, the Church Management platform is the core software that churches rely on for their day-to-day activities. In fact, generosity solutions are viewed as add-ons to the core Church Management software. If Pushpay could offer its own Church Management software, they would be able to bundle their digital giving solutions more effectively (increasing their attach rate), and keep customers on their platform longer since it’s hard to switch the ChMS.

Today, no one company offers all three solutions in a unified solution despite the significant appetite for this product from Churches.

In late 2019, Pushpay acquired Church Community Builder, one of the few leading providers of Church Management Software to complete its suite of products and offer this unified solution. There are now two companies (Pushpay and Tithe.ly) that have the potential to offer all three offerings (a project in progress for both companies), with each targeting different parts of the market. Pushpay is focused on the medium-to-large church segment, and Tithe.ly is focused on the small-to-medium segment.

I believe that once a unified suite is complete and offered to the market, Pushpay will see an acceleration of growth, and ultimately a reduction in customer churn.

Finally, it's worth noting that Pushpay has been exclusively focused on English speaking protestant churches. The Catholic church and Spanish speaking churches are obvious adjacent markets that Pushpay will likely expand to. Other religions such as Judaism and Islam also pose further opportunities. International is yet another opportunity, and outside of the faith sector, Pushpay has ambitions to expand its solutions into the larger non-profit ecosystem.

Putting Numbers to the Investment Case

In typical fashion, I won't be sharing a price target or future estimates here, but I do want to directionally share where Pushpay is going and what that may translate to over time.

Pushpay earns recurring subscription software fees for its engagement and church management solutions, and a 1% transaction fee for each dollar processed through its giving platform.

As of 2019, roughly 15% of the >$100B of church donations were executed digitally, with Pushpay clearing approximately $5 billion. I believe over time we will see an increase in total giving (since digital givers donate more each year than non-digital givers) and, as a percentage of total giving, digital giving should approach >40% of the total. Greater than 65% of all transactions today are conducted via card or digital purchase, so it's not unrealistic to see the majority of faith-based donations go digital as well. Further, according to Pushpay, mature churches on their platform are today collecting around 40% of their donations digitally compared to the 15% industry average. This 40% assumption might prove conservative as Pushpay's key competitor is inertia.

If Pushpay in the medium term transacts $15B through their platform in a given year, and we see reasonable uptake of their unified software, their revenue will be multiples of what it is today ($130m USD) and their annual profitability could reach above $100m USD per year. This compares favorably to the ~$1 billion USD market capitalization at the time of our position purchase. I'll leave the earnings multiple assumption up to others, but if they achieve this level of profit, this high-quality business is likely worth multiples of our purchase price.

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CONCLUDING THOUGHTS

As always, thank you for trusting me with your hard-earned savings, I don't take this responsibility lightly.

These are strange times, and many are still suffering physically, emotionally, and mentally. Everyone is impacted by recent events in their own way, and we're all fighting our own battles. Stay strong, stay positive, stay hungry. We will eventually make it to the other side.

If there's anything I can do to help, don't hesitate to reach out. We're in this together.

Sincerely,

Andrew

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Bonsai Partners

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