February 3, 2021

"2020 is Hindsight, Hindsight is 2020"

Dear Client,

None of us will forget 2020. Collectively, we faced immense challenges brought on by a kind of pandemic that infects humanity once every hundred years. We find ourselves uniquely fortunate, despite the year's turmoil, as we reflect on how incredibly lucky we are to have a wonderful investor base with the tenacity to weather the storm earlier in the year. Our full year results are a direct result of your trust that the soundness of our process will inevitably result in good outcomes. At the same time, we want to caution that the results of this year are unique and will be incredibly challenging to replicate.

Adapting to the new realities of today poses many challenges. We are privileged to have exceptional partners who believe in us and in our investment process throughout. We continue to learn a tremendous amount from you about both in terms of life and business. Thank you for your patience and your cool headedness during the worst market crash since 1987 and for affording us the opportunity to work without distraction. Thank you for the continued opportunity to manage your hard-earned wealth. Thank you for sharing this journey with us. Some of you joined us more than a decade ago. You took a chance on two young gentlemen in this industry. You gave us the opportunity to try and prove our mettle as investors and we are here today as a direct result of your conviction. In recent weeks we have received an outpouring of thanks the likes of which we have never experienced before. It is imperative to us that we stress that it is we who are the lucky ones.

2020 has become a year of reflection for everyone. People find themselves contemplating their past life choices and present life state. The year has prompted us to think about what is most important in life and what sacrifices have been made in the pursuit of something that previously seemed important but were not actually meaningful in an enduring and spiritual way. We have similarly reflected on all of our past and present portfolio company experiences and in doing so, we spent considerable time reflecting on both our successes and failures (errors of commission and omission). In many respects, it has become clear that we as investors have matured and in doing so, we have identified very clearly our own unique recipe for successful investments. You may find us a little more reflective than usual below, though we think that is inescapable after the kind of year that has transpired.

Learn from Mistakes

The winter in early 2016 was our previous peak in turnover, prior to March of 2020. At that time, in a short span, we purchased meaningful positions in Grubhub, Envestnet and what was then Priceline, soon to be Booking. Each of these positions delivered internal rates of return (IRRs) comfortably above what we had hoped for, and two of these positions remained in our book for roughly our full five-year expected holding period. While we are pleased with the results of these specific purchases, we made a huge mistake of omission at that time. This mistake will likely be one of the biggest we ever make in our careers. Specifically, we did deep work on Shopify and loved everything about the business qualitatively. Unfortunately, we ultimately found ourselves unable to get comfortable with the numbers. We built our model up from the key performance indicators (KPIs) that drive revenues. Our last save of the model dated 8/3/2016 looked as follows:

	2012	2013	2014	2015	2016 Hypo	2017E	2018E
Revenue	**23,713**	**50,252**	**105,018**	**205,233**	375,497	562,931	782,795
Subscription Solutions	19,200	38,339	66,668	111,979	182,526	246,410	308,012
Merchant Solutions	4,513	11,913	38,350	93,254	192,972	316,522	474,783
Rev Growth		111.92%	108.98%	95.43%	82.96%	49.92%	39.06%

These numbers seemed right from everything we understood about the company. While we tend not to rely on sell-side consensus estimates before finishing our own workup of the business, we do give them a look once we feel comfortable with how we have approached our analysis as it is often helpful to get a sense of what the average participant in the market expects the business to do. With Shopify, the sell-side consensus was so far from where our numbers were shaking out, it seemed almost impossible that we were basing our analysis on the same underlying information. Our natural next step was thus to take the sell-side consensus data and work backwards to figure out the implied expectations on each of the key revenue drivers. Here is what the sell-side consensus looked like as at the time:

					Sell-side consensus		
	2012	2013	2014	2015	2016 Hypo	2017E	2018E
Revenue	**23,713**	**50,252**	**105,018**	**205,233**	346,702	481,261	602,304
Subscription Solutions	19,200	38,339	66,668	111,979	168,528	210,660	236,993
Merchant Solutions	4,513	11,913	38,350	93,254	178,173	270,601	365,311
Rev Growth		111.92%	108.98%	95.43%	68.93%	38.81%	25.15%

Shopify's actual revenues for 2016-2018 ended up being $389m, $673m and $1,073m. *In other words, not only were we justifiably far more optimistic than the consensus estimate, but we also were far too conservative in terms of how the company actually performed.*

The nature of our job as securities analysts is to take calculated risks, in an uncertain world where the "true" answer is inherently unknowable before the fact. We operate in what many call an "efficient market" and subscribe to the belief that for the most part, markets are generally pretty efficient and it requires differentiated analysis to find a return above what the market can offer. So why did we pass on Shopify despite 1) deeply believing in the qualitative elements of the business; and, 2) seeing a meaningful gap between what we expected and the consensus expected? The answer is unfortunate but simple: **we lacked confidence in ourselves**. It was the first time we truly experienced such a stark divergence between our expectation and the consensus and the result was the inclination was to pound ourselves over the head with how dumb we must be, rather than the other way around. We also learned that the truly great companies use their strong business advantages, smart management and execution to raise the bar every step along the way. Obviously this is a cycle which cannot continue *ad infinitum*, but especially in instances where our qualitative work identifies the inherent strengths in the business and the numbers shake out to be quite fair, the consistent "raising of the bar" can be a potent driver for the stock.

Please do not judge us too harshly for our mistake on Shopify, for we have from the very beginning made one commitment above all else to both our clients and ourselves: **that we will be better today than we were yesterday, and better tomorrow than we are today**. While this mistake was quite costly, it ended up being a key confidence and process builder. In fact, we believe that our Shopify "miss" and the learnings derived from it gave us the confidence to underwrite Roku with conviction in 2018.

For two years running, Roku has now been either the largest or second largest driver of performance in portfolios. When we purchased Roku, obviously we never expected such a phenomenal outcome, so quickly—these things can only be chalked up to luck. However, we do think luck is the residue of design and Roku had all the hallmarks ex ante as the kind of position that could do something wildly spectacular. One of the first signs in seeing Roku's potential was the sharp contrast between our modeled expectations for the top line of the business and where the consensus expectations were. This was the Shopify setup all over again. By this time, we had added an additional tool to our analytical framework, and this helped further enforce our conviction that not only was it we who were right about where things should go, but also that the very existence of this gap could be a potent source of fuel behind the stock as the world came around to our expectation. Specifically, we had become increasingly comfortable building lifetime value analyses of companies, and notably, when we bought Roku, we were quite confident that with only modest annual increases in average revenue per user (ARPU), and a 5-year average customer lifespan, we were buying the company for its existing customer base and nothing more. In other words, the growth at Roku was entirely free at the prevailing prices we bought into.

The World According to GARP

Some have asked us to elaborate on what it means to be a GARP investor. Growth at a Reasonable Price (GARP) is foundational to us as the recipe we follow to guide our decisions. We distill prospective portfolio companies into qualities that are absolute requirements (traits that we are uncompromising in), and niceties which serve as "icing on the top." While we do not require each and every business to present with all traits within "icing on the top" when making an investment, we do need some presence from this section. Our ideal investment obviously has each and every trait, though to the extent that one of our required elements are exceedingly great (i.e. an extremely low valuation or uniquely impressive growth) we will require less of the "icing." We have always relied on a checklist geared around identifying these very traits, but we find that formalizing our criterion in this much simplified way helps us be more disciplined about narrowing our universe of companies we will consider before even running them through our process and also provides a valuable framework for communication as a team and with you, our clients:

Required:

Value-using our valuation processes and applying the appropriate technique in a given situation, we require a degree of identifiable cheapness. In particular, we look at the implied expectations and require those be a reasonably achievable hurdle for the business to meet or better yet, exceed.

Growth-while growth need not be swift, we require some kind of structural tailwind underpinning the growth of the business.

Quality-quality to us means the business takes care of and adds value to each of its key stakeholders, has a management team with aligned interests, and has identifiably strong unit economics. We are also looking for a moat that advantages the business against competition.

Some of our “icing” elements:

Change-situations with change are inherently more likely to be mispriced and change can mean either an industry a business is operating in is undergoing change (digitization being a common one these days) or the segment composition within a business is changing to a more advantageous setup that most others do not yet see.

Strategic asset-we like when a business in and of itself is a strategic asset to a larger, well capitalized player in the ecosystem (it need not be a direct competitor). We view this as both a put and a call option, where if something goes wrong with our core thesis, a purchaser will acquire our way out of trouble, and if someone pays up in the earlier end of our timeframe, our IRR can be pulled forward quite dramatically.

Optionality-we like businesses that have the potential with some catalyst to meaningfully exceed the expectations we outline in our base case. COVID-19 was such a stimulant for several of the businesses we invest in.

We have had considerable successes, some modest successes and some failures. Failures when a given business truly has all of these aforementioned traits have been far less bad (and actually by-and-large profitable) compared to errors made across investments in businesses missing these key components. All of the companies in our portfolio today have, at least at the time our purchase, at least the three required traits and some degree of ”icing.”

Let the Winners Ride

Importantly, while we call ourselves uncompromising on value, we are willing to let successful positions extend themselves beyond what we would consider cheap enough to buy. We have some constraints on how large we will let a disproportionately successful position grow, but the absence of value alone is not deterministic in our selling of a position. This is especially true when the optionality of a given thesis is provably being exercised. This brings us back to Roku. While Roku entered 2020 extended on price charts and relative to how much progress the business had made in the prior year, we trimmed down the position to a more comfortable holding size given our expectation that the company needed some time to grow into its valuation. Though we never anticipated it, we stumbled into an opportunity to buy meaningfully more during the late spring and early Summer.

From there, we held on, even as prices soared. Roku uniquely grades out very highly on each one of the elements listed above (leaving valuation aside today).

Growth--A long-term, secular growth tailwind, with consumers rapidly adopting CTV as their core TV watching platform and advertisers swiftly moving budget to catch those eyeballs.

Quality--A high quality business, with already proven, strong unit economics that are improving as viewers shift more time from linear to OTT, as AVOD takes share from SVOD and as advertisers move more budget to the platform. This is all happening amidst the backdrop of widening advantages against competition.

Change--A revenue composition inflection where a hardware company became a platform company and an industry itself was realigning around technological change (the linear to CTV and boring to smart TV transitions).

Strategic asset—Roku has the largest market share in a strategically important area for many larger players (including big cap technology companies, content companies, connectivity companies, etc.).

Optionality--the potential for something way better or faster than in even the bull case in the analyst word to happen for the company. In past terms, it meant there could have been something catalytic that accelerated cord cutting. This happened with COVID. In forward terms, we think about the opportunity to expand internationally and to embed native commerce into the platform as two big ones.

For two years in a row, we find ourselves thinking "never in our wildest dreams did we expect things to play out this well, this quickly;" however, at the same time, Roku continues to exceed our most optimistic expectations within its core business. *Truly great companies have a unique way of raising the bar every step along the way.*

Don't Anchor to Where Price Started

While we say we missed Shopify in early 2016, the fact of the matter is, we missed it repeatedly between 2016 and 2018, when prices were comfortably above our uncompromising value framework. In effect, we missed purchasing shares in this company every single day we woke up for two years running, largely as a consequence to anchoring bias. Anchoring bias as defined in The Decision Lab is "a cognitive bias that causes us to rely too heavily on the first piece of information we are given about a topic."[1] In investing, this means we think far more about where a stock price has come from than what the business itself is worth today. We often tell ourselves we are immune from this bias and we commence our analysis without thinking about where the stock has come from, while focusing on the qualitatively significant elements of the business and building our reverse DCF to identify the drivers of value and the hurdle rates for achieving our desired returns. The problem is that with Shopify, we anchored to where our own analysis started, and this was a vulnerability we had not considered.

We hope Shopify once again becomes a powerful lesson in what not to do with the company we hinted about in our Q3 commentary—Naked Wines. We started accumulating our shares over the summer and rounded out our position during the fourth quarter of last year. We first encountered Naked Wines (WINE) in December 2019 when Norbert Lou of Punch Card Management (who notably does indeed live up to the punch card mantra) disclosed a substantial position in the company. We started our research immediately. By late February we had read enough to be interested and ordered mixed case starter packs to the office. We shared bottles with everyone on our floor willing to try some wine with the explicit intent of soliciting any and all feedback. Who would have known that a few weeks later would be the last time we set foot in our Connecticut office to work? Who would have known that come March, WINE would go up nearly every single day while the broader market's collapsed? Who would have known how many other things—from broad to specific—we would focus on in the interim without thinking about Naked Wines for some time.

In June, we received a friendly prompt from Shai Dardashti of the Casulo Group asking if we had done any work on Naked Wines and Elliot's verbatim response was "I ordered a box, sampled the wines, but then the lockdowns started, and I hadn't done nearly enough work and the stock went parabolic. I can't decide if it's too late...but it certainly is very intriguing!" As we conceptualized the framework we put forward in our Q2 commentary reflecting the belief that there would be a further bifurcation within the COVID "winners" and "losers" brackets, we realized it was imperative we dis-anchor any and all analysis from where stocks have come from and focus purely on the intrinsic setup of the situation.[2] This would be especially important when our belief could be substantiated that a company was a winner, experiencing

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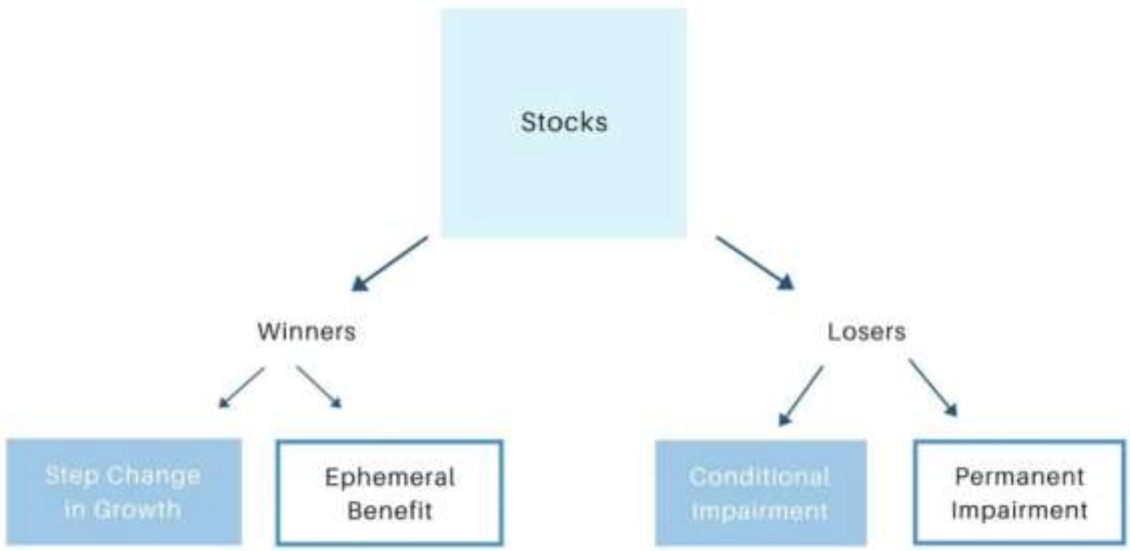
[1] https://thedecisionlab.com/biases/anchoring-bias/#:~:text=Anchoring%20bias%20is%20a%20cognitive,instead%20of%20seeing%20it%20objectively

[2] https://www.rgaia.com/commentary/q22020-investment-commentary-the-tale-of-two-markets/

a "step change in growth." While we always have aspired to analyze a company first and connect the analysis to price and the path traveled later, we are human, and it is quite challenging to stare at something that has 2x'd in a month and get excited that upside remains.

This chart from that aforementioned Q2 commentary was crucial in getting us there:



The origin story of Naked Wines is in and of itself another reason not to anchor on the stock chart's path. Naked Wines first launched in 2008 and was bought by Majestic Wine in 2015. Majestic Wine was a publicly-listed, UK wine retailer that bought Naked Wines in order to deploy their lush but stagnant brick and mortar cash flows into a growth asset. [3] In early August of 2019, Majestic Wines arranged to sell itself, but leave behind the growth subsidiary and reorganize its entire corporate imperative around the Naked Wines growth opportunity. This is similar to the setup that brought us into Acxiom/LiveRamp a few years back, though this time the opportunity is even more compelling.[4] The crucial step in realizing the extent of the opportunity for us was setting aside this thought that perhaps "we missed it" and instead recognizing that the company today is not the company whose story the lines on charts actually tells.

An Advantaged Business Model

Naked Wines described itself as "a customer-funded wine business" whereby the customers, affectionately called "angels" "fund talented winemakers and give them the freedom to make wines the

[3] https://www.thedrinksbusiness.com/2015/04/majestic-buys-naked-wines/
[4] https://www.rgaia.com/commentary/q118-investment-commentary/

way they want to." "Angels" commit in subscription-like fashion to fund an "angel" account at Naked Wines with a minimum "investment" of $40 per month. This commitment opens up discounted pricing on Naked Wines' entirely unique inventory. The $40 per month is a powerful force for three reasons:

1) The Cialdini Commitment Concept—"When someone agrees to something small, they are likely to be consistent and go along with a bigger idea later" (an idea we were first introduced to in the book *Influence* by Robert Cialdini and summed up nicely in the linked article below).[5] Customers who become angels are thus committing in advance to purchase at least a portion of the wine they consume from Naked Wines.
2) The $40 pre-commitment gives Naked Wines very good visibility into what their forward demand will look like and helps efficiently manage the business along the way.
3) The $40 per month comes in before actual expenditures on the platform, thus funding inventory investment for the business enabling Naked Wines to operate with minimal working capital.

These advantages also materialize for winemakers who sell their wine through Naked Wines. Naked can pre-commit to winemakers with a certain level of promised demand, giving winemakers a degree of comfort previously impossible in the industry. Further, winemakers get this without having to convince distributors or retailers (depending on the country) to buy their product, which can be costly and frustrating.

Although Naked Wines started in the UK, its advantages are especially amplified in the US which is encumbered by a three-tier distribution system in alcohol.[6] In the three-tier system, when we purchase a bottle of wine at a local liquor store, that bottle first had to earn margin for the winemaker and then for the distributor. The three-tier system is a consequence of how the US pursued our exit from prohibition and it was recently affirmed as constitutional by the Supreme Court.[7] Naked Wines is legally structured as a "vineyard" in the US which means they can sell direct to customer and work around the distribution middleman. As a result, a bottle sold through Naked Wines sells for much less than a bottle with equivalent rankings sold through traditional channels:

[5] https://healthcaresuccess.com/blog/case-studies-best-practices/cialdini-commitment-concept.html#:~:text=It%20goes%20like%20this%3A%20When,Robert%20Cialdini.
[6] https://en.wikipedia.org/wiki/Three-tier_system_(alcohol_distribution)
[7] https://www.scotusblog.com/case-files/cases/tennessee-wine-spirits-retailers-association-v-blair/

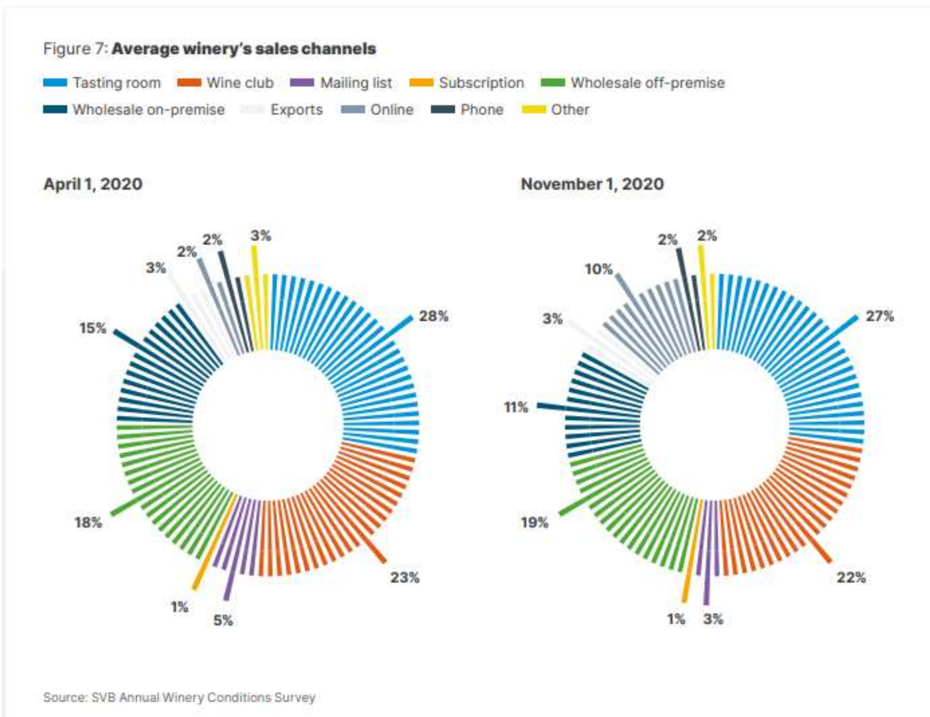
[8]

The magnitude of the US opportunity and the inflection from small geographic revenue segment within Naked Wines to approaching half of the business was part of the rationale behind selling Majestic and honing in on the opportunity with Naked Wines.

[8] Naked Wines plc 2020 Full Year Results Presentation

The Wine Sales Channels:

Vineyards can sell direct to customers; however, it is incredibly challenging to build up that business. Most vineyards sell direct in the form of wine clubs, mailing lists and the tasting room, with wholesale making up a large portion of the business:



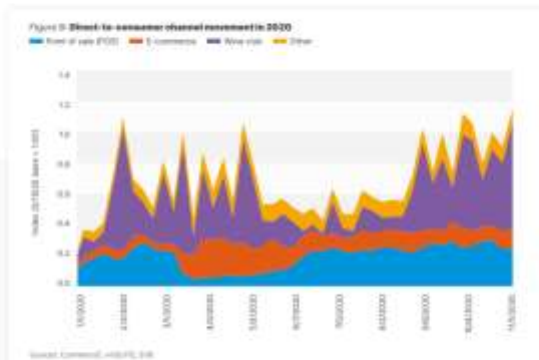
[9]

The fact that wine is traditionally purchases at retail has made it such that even in the direct sales channels, prices reflect the premium required to fulfill the margin needs of the distributor and end retailer. In some respects, vineyards have actually sold their own wines at a higher price than can be found at retail, because their direct customers are most captive (at the vineyard) or loyal (mail club/wine club members).

Naked Wines was already undergoing dramatic change following the Majestic sale, and with COVID those changes were extremized.

[9] https://www.svb.com/globalassets/trendsandinsights/reports/wine/sotwi-2021/svb-state-of-the-us-wine-report-2021.pdf

Alcohol had relatively low ecommerce penetration compared to other verticals and that no longer remains the case:

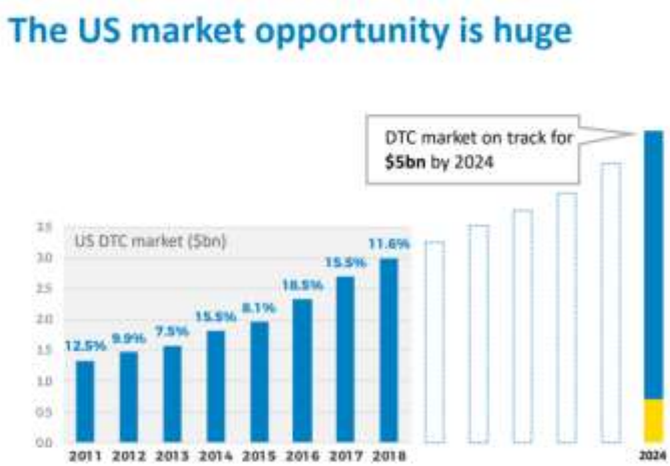

[10]

Clearly the direct channel, between ecommerce and wine clubs have become critically important and we think Naked Wines is fantastically positioned to extend its successes. The market opportunity is large:

[11]

[10] Ibid
[11] Naked Wines plc 2020 Full Year Results Presentation

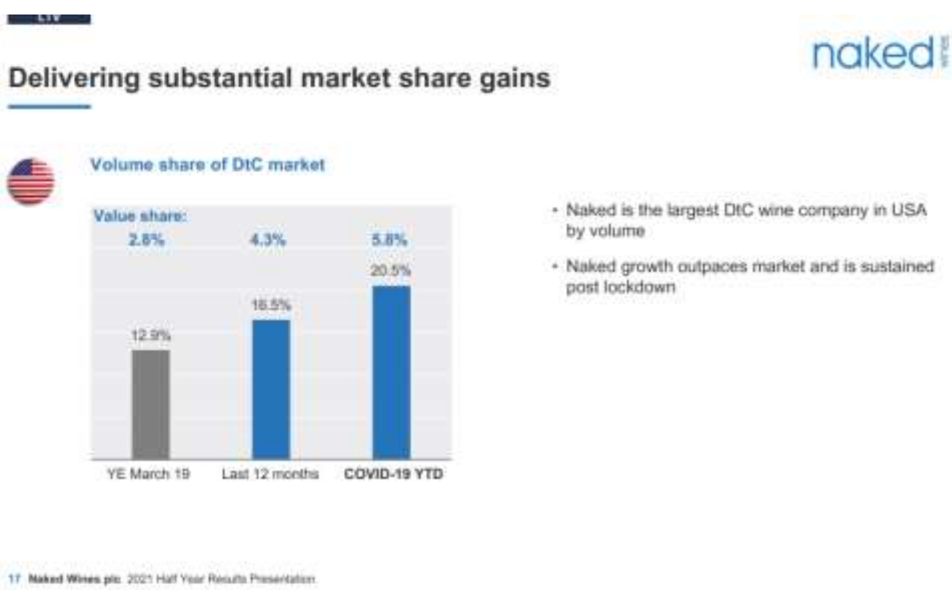
And even with the COVID acceleration, minimally penetrated:



[12]

Delivering Quality

Naked Wines has won meaningful market share in the US DTC market, though that market share is considerably greater in bottles shipped than dollars of revenue (20.5% and 5.8% respectively):



[13]

[12] https://www.sovos.com/shipcompliant/content-library/wine-dtc-report/

[13] Naked Wines plc 2021 Half Year Results Presentation

While Naked Wines has captured a meaningful portion of the volume TAM, the portion of dollar value TAM they have captured is much smaller. The value TAM is much greater as you get into the $20-40 dollar per bottle range.

This will be especially important to our thesis shortly, but for now it is important to understand how the industry is geared:

[14]

Naked Wines is so dominant in the lower ASPs because it was built to efficiently fulfill a customer's needs for finding cheap quality. Wine however is in some critical respects a Veblen Good (for those unfamiliar, a Veblen Good is a product whose demand increases as price goes up). In one of our earlier conversations with the company, they explained how a mistake in the US four years ago was "focusing too much on

[14] https://www.sovos.com/shipcompliant/content-library/wine-dtc-report/

value and low price." Increasing prices per bottle by $3-4 each immediately led to higher ratings on wines. This is both a challenge and opportunity. It also reflects the fact that early customers were intrigued by the combination of value and quality.

Meanwhile, the entire industry has geared its entire DTC strategy around selling the highest price points. Shipping is incredibly complex in taking a perishable, delicate product, packaged in glass and getting it from vineyards (primarily on the West Coast) to households around the United States. In our conversations with vineyards and surveys of the industry, typical shipping costs range from $60-$120 for a case of 12 bottles, depending on the level of service required. Some elite vineyards simply will not ship product to the NY area between the months of May and October, because warm temperatures imperil the product along the way. In order for a customer to justify paying $60-120 for a case of, it is reasonable to think that no more than a 10% markup per bottle will be acceptable. Consequently, at the low end, that means customers are looking at $50 bottles per wine and up. According to the Sovos DTC Wine Shipping Report, "wines price $100…outperformed the overall DTC channel" each year since 2013.[15]The industry has built its entire shipping edifice around justifying high prices, and above we mentioned how vineyards sometimes price even more aggressive selling direct than at retail, the logistical challenges along the way are but one powerful reason. Most customers of these wines from the industry must wait a week or more to receive the product. This is ok for someone in a "club" where they expect a certain cadence of deliveries, but not ok in the world of one-click checkout convenience.

Since Naked Wines built its entire presence around shipping cheap wines at affordable prices, they had to solve a different problem than the industry at large. Whereas the industry at large was thinking about how to "premiumize" their DTC efforts and drive ASPs upwards, Naked Wines focused on how to ship product more efficiently and cheaper to their customers. In order to ask people to pay approximately $12/bottle, even at the low end of industry shipping costs, you would be asking your customers to pay 40% more for the privilege of getting these wines ($60 shipping cost on $144 of wine). That is not good a great value proposition. As a result, Naked Wines has established four fulfilment centers around the US, the company can not only get product to most major metropolitan areas within 48 hours of the placement of an order, but they can also actually do so far more economically.

[15] https://www.sovos.com/shipcompliant/content-library/wine-dtc-report/

Here's what the average cost structure of a shipment looked like across Naked Wines:

Repeat Customer Shipment	**2018**	**2019**	**2020**
Revenue / Case	£ 132.00	£ 132.00	£ 132.00
COGS / Case	£ 64.00	£ 50.68	£ 50.46
Distribution Cost / Case	**£ 19.08**	**£ 17.82**	**£ 18.19**
Fixed Costs / Case	£ 17.99	£ 20.46	£ 18.39
Contribution / Case	**£ 30.93**	**£ 43.04**	**£ 44.96**
Contribution Margin / Case	23.4%	32.6%	34.1%

New Customer Shipment	**2018**	**2019**	**2020**
Revenue / Case	£ 48.00	£ 48.00	£ 48.00
COGS / Case	£ 32.20	£ 18.43	£ 18.35
Distribution Cost / Case	**£ 19.08**	**£ 17.82**	**£ 18.19**
S&M / Case	£ 31.33	£ 35.95	£ 37.64
Contribution / Case	**-£ 34.61**	**-£ 24.20**	**-£ 26.18**
Contribution Margin / Case	-72.1%	-50.4%	-54.5%

These numbers are assumptions based on iterative calculations we have done to solve for the approximate number of cases shipped based on our assumption around ASP. They are not designed to be perfect, though through our conversations with the company and people in the industry we know they are at least ballpark. The key point is that for $25 all-in (18 GBP converted to USD), or less than half the brunt of what the rest of the wine industry faces, Naked Wines can get wines to your door. Our understanding is that the true price is even better; however, it's hard to parse out some of the fine-tuned elements of from consolidated financials. Further, this $25 is not comparing apples-to-apples, because the $60-120 range for the industry does not include other costs associated with distribution that Naked Wines embeds in here (like fulfilment centers and staffing around fulfilment).

The ability to fulfill an order for a customer within an extremely reasonable window at a fraction of the cost compared to the industry is a major advantage. It amplifies the relative price advantage on wine itself. Further, in an industry that has an incredibly fragmented supply side (thousands of vineyards, only three scale owners and that scale is modest), with all incentives geared towards moving ASPs upwards, the Naked Wines advantages get larger every single day.

"Cheap quality" → "Affordable Luxury"

Importantly, the advantages of Naked Wines have given them a wedge into the industry. Using this wedge, Naked Wines has achieved greater than 20% volume share, which has translated some of the initial relative cost advantages into an added layer of scale advantages. They have done this building a customer base around "cheap quality." There is a certain wheelhouse customer and product assortment that by mandate and corporate imperative while under the Majestic purview that Naked Wines had to fulfill—they had to cater to the 40-60 year old wine drinker who basically was in search of cheap quality. This meant that the company could not truly experiment with a wider assortment of kinds of wine, vintages, and ASPs. In order to invest in some of the more expensive wines, it would take a leap of faith and not a simple a/b test-and-learn kind of setup.

Management recognized early in COVID that the trajectory of the business had meaningfully accelerated and their biggest bottleneck to growth of having the resources to invest in customer acquisition was no longer the threshold factor to grow faster. Naked Wines saw this as an opportunity to help the winemaking community while enhancing the quality and range of wines offered on the platform in offering a "COVID Support Fund" for winemakers impacted by the COVID lockdowns.[16] Jesse Katz was the first winemaker funded in the COVID support effort and he offers an important indication for where Naked Wines can go. Jesse is one of the young, up-and-coming stars in the industry who has produced some of the highest quality, most interesting and notably expensive bottles of wine in the world.[17] His first offering on Naked Wines sold out within 24 hours, at a $42 ASP (compared to a core average of around $12).[18] Jesse is the kind of winemaker with a growing following who can pull in more sophisticated, higher value customers, while lifting upward the range of both quality and price on the Naked Wines platform. He is committed to bringing more wine to the Naked platform and we are confident this will be incredibly successful for both Jesse and Naked Wines.

Early in COVID, in a world where people were specifically seeking out "wine at home" during lockdowns, management also recognized that new channels for customer acquisition could be promising (whereas historically customer acquisition leveraged flyer inserts that looked like gift cards like what you get in a Wayfair or Bed Bath and Beyond). They have committed more budget to Facebook and other high-return online verticals. In fact, customer acquisition was so efficient online in early COVID that the bottleneck

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[16] https://news.nakedwines.com/2020/04/24/covid-support-fund/

[17] https://www.decanter.com/wine-news/opinion/news-blogs-anson/jesse-katz-winemaker-setting-382922/

[18] https://www.nakedwinesplc.co.uk/wp-content/uploads/Naked-Wines-H1-FY21-Investor-Presentation_lowres.pdf

was no longer acquiring customers, but rather ensuring there was enough depth and assortment in inventory to maintain a compelling customer value proposition. This is a good problem and important evolution in the business. Importantly, the better the quality on the platform, the broader the assortment, the easier it is to acquire customers and the better the quality of customers that Naked Wines can bring in.

If Naked Wines can gradually shift their customer base upwards and get their ASPs to rise into the low $20s/bottle, the TAM they can address is much larger than the sub-$20 range they dominate today. If they can evolve the narrative from a place to discover “cheap quality” to one that brings customers “affordable luxury” the economics of the entire model improve. With “affordable luxury” Naked Wines will bring on higher value customers and most importantly, with the cost per case essentially fixed, they can 2.5x or more their contribution per case shipped. So not only would this greatly increase the pool of revenue Naked Wines can compete for, it can also expand the low double digit long-term margin target the company has offered.

The Winemaker Value Prop

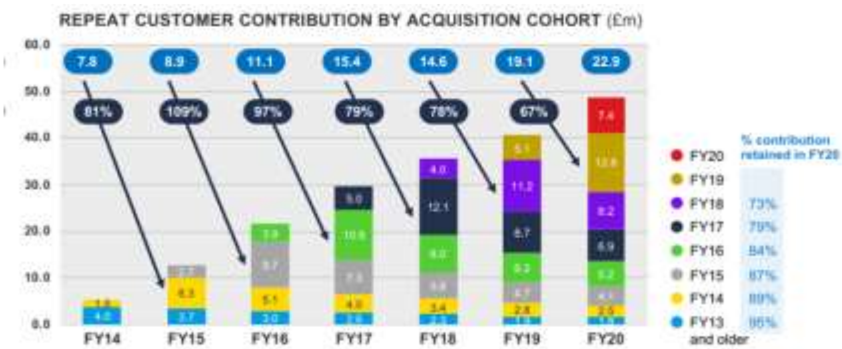
In order for Naked Wines to be the “vineyard” for regulatory purposes, Naked Wines employs the winemakers as independent contracts and offers everything from issuing purchase orders for grapes to crushing services to bottling in order to get the raw grape to market as wine. There is a fixed salary component based on the expected demand and a variable piece that rewards outperformance. The amount they pay a winemaker depends on their reputation and quality, as one would expect.

We made references along the way, but it deserves its own section. Winemakers are drawn to Naked Wines for several reasons. First and foremost, the economics of being a winemaker in Naked Wines yields a similar gross profit per bottle, with greater visibility into demand, thus requiring less overall working capital in the business. Plus, Naked Wines offers winemakers much higher volumes than they otherwise could garner through other sales channels. Similar gross profit margins and greater volume ends up in much more profitability. Importantly, the visibility into demand, and Naked Wines handling customer acquisition means winemakers themselves can focus more on making the wines they are passionate about rather than spending time hustling and begging distributors to get them a market presence in a given state and then helping retailers drive awareness to their bottle on a wall of dozens of competing offerings. It is incredibly challenging for an independent producer to get distribution. Naked Wines offering is incredibly compelling on this front.

Instead of appealing to distributors, Naked Wines encourages winemakers to respond to the reviews and community feedback on each bottle received on the website or app. This community element is powerful, insofar as each bottle is rated and the data that the company is accruing on this helps steer winemakers to product they know will sell. Some winemakers have told us it can be emotionally challenging at times to encounter negative reviews, especially in instances where customers are critiquing more a misfit with their style than the actual wine itself; however, they have said this is less of a challenge than fighting for distribution.

Customer-level Unit Economics

While we had to do some work, make some assumptions and tap numerous industry sources to triangulate the unit economics of a shipment, the disclosures that Naked Wines provides on customer-level unit economics are some of the most transparent, complete and straightforward in the DTC ecommerce universe.



[19]

Naked Wines shows us the repeat customer contribution from each cohort, by year in which they started as angels. They also show us cohort CAC:LTV by customer vintage:

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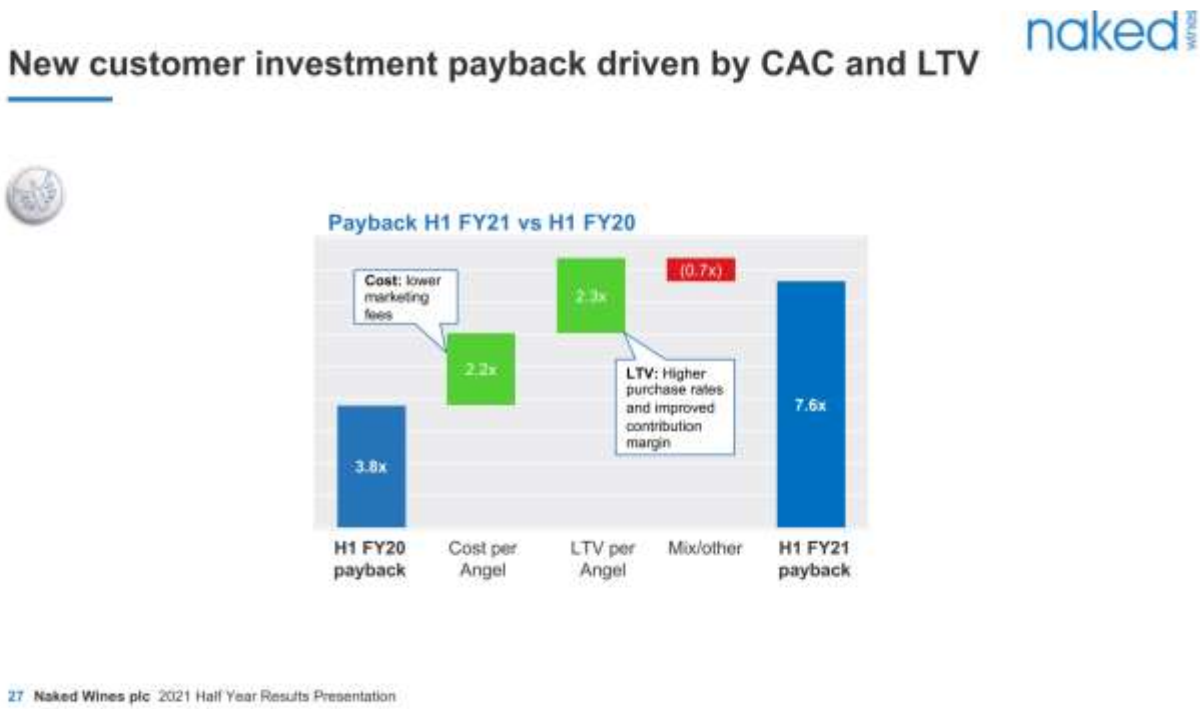
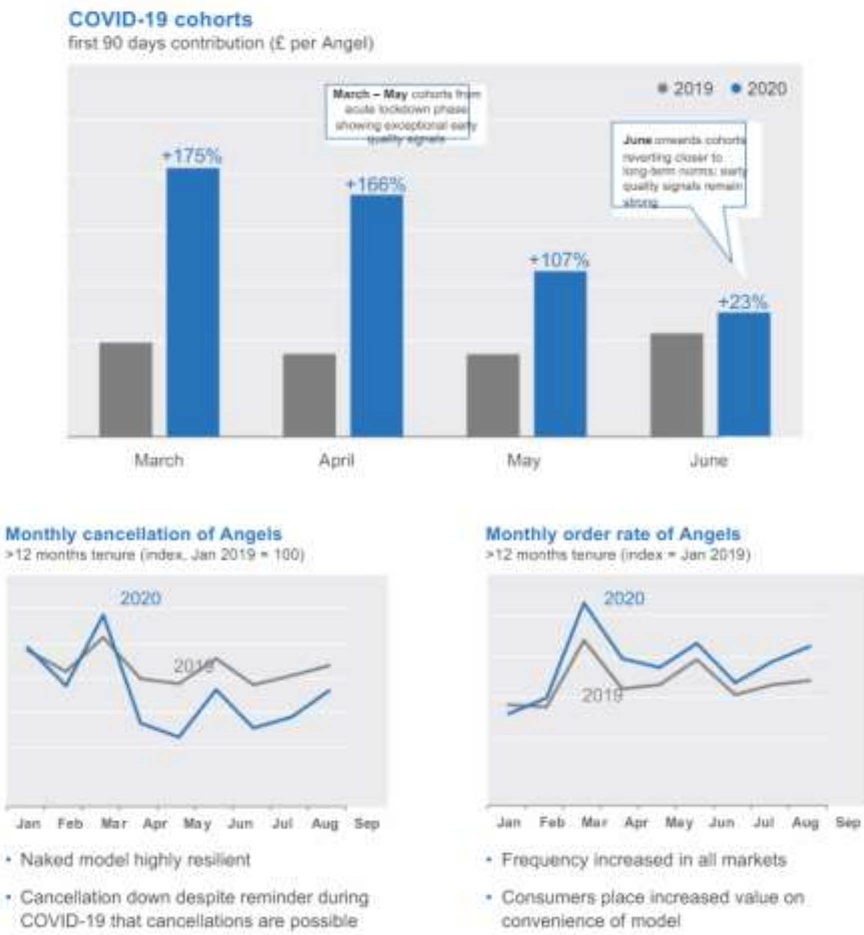
[19] Naked Wines plc 2020 Full Year Results Presentation



[20]

Performance is incredibly consistent across cohorts, though notably during COVID behavior of existing cohorts improved dramatically (churn dropped and orders per customer increased), while new customers were acquired at even higher LTV/CAC rates. This is so partly because of the aforementioned ease with which customers came in and partly because channels like "dining out" which were important sources of demand for the wine industry were replaced with at-home behavior. Most of the increase is the enduring variety (acquiring better customers) rather than the ephemeral (dining out will resume). Moreover, the size of the cohort of new customers, evidenced by the first half of 2021 (they are halfway through the 2021 reporting year as of October) having three times the new angels as all of 2020 brought in (which included a few weeks of COVID benefit during the fiscal year's last month).

[20] Naked Wines plc 2021 Half Year Results Presentation



[21]

We could take the company's filings and build out our own valuation of an average customer:

[21] Naked Wines plc 2021 Half Year Results Presentation

Year		1		2		3		4		5			20
Revenue/Active Angel	£	342	£	349	£	356	£	363	£	370		£	498
COGS/Active Angel	£	127	£	133	£	136	£	139	£	141		£	190
Distribution Costs/Active Angel	£	40	£	40	£	40	£	40	£	40	...	£	40
Fixed Costs	£	41	£	41	£	41	£	41	£	41		£	41
Contribution	**£**	**134**	**£**	**134**	**£**	**139**	**£**	**143**	**£**	**148**		**£**	**227**
Contribution Margin		*39.1%*		*38.6%*		*39.1%*		*39.6%*		*40.0%*			*45.6%*

While Naked Wines historically disclosed a 20-year LTV, with their year-end 2020 filing in March of this year, the company made 5 year LTV a new disclosure. While there is some merit (evidenced by churn rates in years 5 and beyond of cohorts below) that twenty years may be appropriate, five years is far more reasonable to consider for a company that is not yet twenty years old. It also helps us investors triangulate value from multiple perspectives. At historical rates of churn and payback the key metrics sum up as follows:

CAC	-£	273
Payback In Years		1.75
5 year LTV per Angel	£	527
20 year LTV per Angel	£	1,373
5 year LTV/CAC		1.9x
20 year LTV/CAC		5.0x
Current Angels		757,000
LTV of Current Angels at 5 Years (in millions)	£	399
LTV of Current Angels at 20 Years (in millions)	£	1,040

Notably, at our average purchase price, we were buying shares for well less than the 5 year cumulative LTV of their existing customer base. Stated another way, growth was literally free for us in this position, much as it had been in Roku. Meanwhile, in their most recent quarterly report, the company reported an 80% year-over-year increase in sales! The key takeaway on the unit economics is that not only is the company cheap relative to its existing customer base, but also the company is actually profitable and in pursuing that profitability, it may not always report true net income while investing in growth (though things happened so swiftly in the first half of this year, that they are unfortunately…yes unfortunately profitable, because they could not invest the benefits of their growth quickly enough).

With the disclosures on cohort profitability and retention thereof, we were able to build out our bottoms-up expectation for what the business can earn organized by cohort:

Repeat Customer Contribution Profit (in millions)							
Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
2013 Cohort	£ 4.0	£ 3.7	£ 3.0	£ 2.6	£ 2.3	£ 1.9	£ 1.8
2014 Cohort	£ 1.5	£ 6.3	£ 5.1	£ 4.0	£ 3.4	£ 2.8	£ 2.5
2015 Cohort		£ 2.7	£ 9.7	£ 7.3	£ 5.8	£ 4.7	£ 4.1
2016 Cohort			£ 3.9	£ 10.8	£ 8.0	£ 6.2	£ 5.2
2017 Cohort				£ 5.0	£ 12.1	£ 8.7	£ 6.9
2018 Cohort					£ 4.0	£ 11.2	£ 8.2
2019 Cohort						£ 5.1	£ 12.8
2020 Cohort							£ 7.4
2021 Cohort							
2022 Cohort							
2023 Cohort							
2024 Cohort							
2025 Cohort							
Repeat Customer Contribution Profit	**£ 5.5**	**£ 12.7**	**£ 21.7**	**£ 29.7**	**£ 35.6**	**£ 40.6**	**£ 48.9**

Repeat Customer Contribution Profit Retention							
Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
2013 Cohort		93%	81%	87%	88%	83%	95%
2014 Cohort		420%	81%	78%	85%	82%	89%
2015 Cohort			359%	75%	79%	81%	87%
2016 Cohort				277%	74%	78%	84%
2017 Cohort					242%	72%	79%
2018 Cohort						280%	73%
2019 Cohort							251%
2020 Cohort							
2021 Cohort							
2022 Cohort							
2023 Cohort							
2024 Cohort							
Global Retention		182%	140%	114%	106%	100%	102%

When we trace out the cohorts from here, the bigger picture looks like this:

Cohort Analysis Sales Buildup	**2021**	**2022**	**2023**	**2024**	**2025**
Repeat Customer Sales	£ 264.8	£ 336.7	£ 434.2	£ 541.3	£ 649.0
New Customer Sales	£ 65.0	£ 51.1	£ 75.0	£ 94.7	£ 123.8
Total Sales	**£ 329.8**	**£ 387.8**	**£ 509.2**	**£ 636.0**	**£ 772.7**
Repeat Customer Sales % Growth	*52.4%*	*27.1%*	*29.0%*	*24.7%*	*19.9%*
New Customer Sales % Growth	*122.6%*	*-21.4%*	*46.9%*	*26.3%*	*30.7%*
Total Sales % Growth	***62.5%***	***17.6%***	***31.3%***	***24.9%***	***21.5%***
Repeat Customer Contribution Profit	£ 72.8	£ 94.3	£ 123.7	£ 157.0	£ 191.4
New Customer Net Contribution Profit	-£ 45.5	-£ 35.7	-£ 52.5	-£ 66.3	-£ 86.6
Total Contribution Profit	**£ 27.3**	**£ 58.5**	**£ 71.2**	**£ 90.7**	**£ 104.8**
Repeat Customer Contribution Margin	27.5%	28.0%	28.5%	29.0%	29.5%
New Customer Contribution Margin	-70.0%	-70.0%	-70.0%	-70.0%	-70.0%
Total Customer Contribution Margin	**8.3%**	**15.1%**	**14.0%**	**14.3%**	**13.6%**

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DCF	2021	2022	2023	2024	2025
Total Contribution Profit	**£ 27.3**	**£ 58.5**	**£ 71.2**	**£ 90.7**	**£ 104.8**
Fixed Costs	-£ 33.5	-£ 38.5	-£ 46.2	-£ 53.2	-£ 59.8
Adjusted EBIT	**-£ 6.2**	**£ 20.0**	**£ 25.0**	**£ 37.5**	**£ 45.0**
Net Finance Charge	-£ 0.5	-£ 0.5	-£ 0.5	-£ 0.5	-£ 0.5
EBT	**-£ 6.7**	**£ 19.5**	**£ 24.5**	**£ 37.0**	**£ 44.5**
Tax Expense	£ -	-£ 3.7	-£ 4.7	-£ 7.0	-£ 8.5
Net Income	**-£ 6.7**	**£ 15.8**	**£ 19.8**	**£ 30.0**	**£ 36.0**
Capex	-£ 1.6	-£ 1.9	-£ 2.5	-£ 3.2	-£ 3.9
Working Capital	£ -	£ -	£ -	£ -	£ -
D&A	-£ 1.6	-£ 1.9	-£ 2.5	-£ 3.2	-£ 3.9
FCF	**-£ 10.0**	**£ 11.9**	**£ 14.8**	**£ 23.6**	**£ 28.3**
N	0.125	1.125	2.125	3.125	4.125
PV	**-£ 9.9**	**£ 10.7**	**£ 12.0**	**£ 17.5**	**£ 19.1**

KPI Sales Buildup	2021	2025
Number of Angels	800	1,500
Orders Per Angel	2.5	2.25
ASP per Bottle	£ 11.00	£ 16.11
CAGR		10.0%
Bottles Per Oder	12	12
KPI Sales Buildup	**£ 264.0**	**£ 652.3**
DCF/Retention Sales Buildup	£ 264.8	£ 649.0

WACC	10%
2025 Repeat Customer EBIT	£ 132
Implied SS EBIT Multiple (10% Margin)	29.8x
Terminal Multiple	17.5x
Terminal Value	**£ 2,304**
Pv of Terminal Value	£ 1,558
PV of Projection Period Cash Flows	£ 50
EV	**£ 1,608**
Net Cash	£ 74
Market Cap	**£ 1,682**
Shares Outstanding	75
Price Target	**£ 22.4**
Current Price	£ 6.8
Target Price Multiple of Current Price	**3.3x**

As the time of this writing, we see considerable upside despite the stock having already moved in our favor. We can triangulate this level of upside from our DCF by looking at a broad universe of comparable companies and their respective multiples:

Company	FY 2021E Sales Growth	EV/FY 2021E Sales
1-800-FLOWERS.COM, Inc.	21.8%	1.3x
Chewy, Inc.	45.9%	5.1x
Domino's Pizza, Inc.	4.0%	4.5x
Hilton Food Group plc	17.9%	2.6x
Revolve Group, Inc.	18.1%	3.6x
Stitch Fix, Inc.	24.8%	3.1x
THG Holdings plc	31.4%	5.7x
Wayfair Inc.	12.6%	1.9x
Average	**22.1%**	**3.5x**
Naked Wines plc	**62.5%**	**1.2x**

[22]

It is clear to us that Naked Wines is in the lowest end of the multiple range here, with the highest growth and if not the "best" of the pack, at least in contention for being so in quality terms.

The optionality:

Everything we have asserted about this business is based on how things stand today. Importantly, we think there are considerable upside levers that could drive more revenue and add more value for stakeholders over time. First, is the new "Wine Genie" offering geared towards broadening the funnel to younger demographics—the kinds of age groups raised on Netflix and the recommendation engine. Wine Genie uses the considerable data assets Naked Wines has and is building in order to determine your taste profile and offer a periodic assortment geared towards your pallet. We like that this has strong resonance in a demographic range that Naked Wines has yet to truly penetrate.

Second, we think there is a big opportunity for earned media and virality. Naked Wines is starting to get some good press about outstanding winemakers coming onto the platform and sales being incredibly strong for the holiday period.[23] [24] Earned media can meaningfully drive down customer acquisition costs.

[22] Market data: Sentieo January 15, 2021
[23] https://www.forbes.com/sites/cathyhuyghe/2021/01/19/rethinking-online-sales-for-premium-wineries-nakedwinescom-in-the-covid-era/?sh=6ba2f2093c10
[24] https://www.thetimes.co.uk/article/christmas-comes-early-for-naked-wines-2wpz8rmls

Relatedly, we think there is a big opportunity to enhance the member-get-member program and leverage angels as a referral source. They are starting to experiment with this more and we expect to see some results. We think there were two missing links that are now resolving themselves: 1) scale in a given region—the more scale, the more natural it is to refer friends; and 2) it is very hard to want to recommend something that is "cheap" even if quality, but it is exciting to recommend affordable luxury. This subtle change makes a huge difference.

Lastly, part of why Naked Wines is so cheap is that company came into existence out of a high cash flowing dividend payer and morphed into a fast grower with little to no reportable profit, while the company is listed in the UK with a far larger opportunity in the US. There is an inherent mismatch in the existing investor base and in the awareness and accessibility of the opportunity. The company suggested on their last call that if the value they deliver "over the course of the next 6-12 months" does not show "value for it, then maybe you look at different things." We are neither advocates for or against a redomicile to the US, though we do recognize that there could be an opportunity to narrow the valuation gap with a reasonable peer group in doing so. First and foremost though, let Naked Wines keep delivering and in doing so, we are confident good things will happen.

Positioning for 2021

While our portfolios performed exceptionally well in the wake of the COVID crash, we take extra pride knowing our positioning was the result of making challenging choices in a demanding environment. We came into COVID overweight financials, with large positions in a theme park operator, a point-of-sale heavy pseudo merchant acquirer, and a sports betting operator facing no sports at all for some indeterminate amount of time, to name a few. The challenges and questions were many and we acted decisively, especially with respect to our financials positions—we did NOT want to find ourselves fighting against the Federal Reserve Bank's commitment to maintain rates at zero for an extended period again. This left us with a large cash balance (we did not sell all the aforementioned exposures) that we had the opportunity to slowly and steadily reallocate as we gained conviction in our framework of how to truly break down winners and losers in our new normal.

As we look out to 2021, we think there are pockets of extreme exuberance, bordering on euphoria in financial markets, though this exists against a really strong fundamental backdrop and fairly average (albeit modestly expensive) valuations across the broader S&P 500. Technology as a theme has been on the receiving end of flows and lush valuations for the past few years and the extremes became even more so in the months following the COVID crash. That said, we continue to find outstanding opportunities in our wheelhouse--$500 million to $10 billion dollar market cap companies, with strong structural growth tailwinds and reasonable valuations.

Thank you for your trust and confidence, and for selecting us to be your advisor of choice. Please call us directly to discuss this commentary in more detail – we are always happy to address any specific questions you may have. You can reach Jason or Elliot directly at 516-665-1945. Alternatively, we've included our direct dial numbers with our names, below.

Warm personal regards,

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