July 7, 2021

Shreekkanth ("Shree") Viswanathan
President | Portfolio Manager
36 Berkshire Lane | Lincolnshire, IL 60069
T # 312-972-4217
Email: shree@svncapital.com

Dear Partner,

SVN Capital Fund's portfolio returned 16.7% gross and 15.3% net of all fees in the first half of 2021. Your return will be different depending upon when you invested.

In the following pages, I will walk you through changes to the portfolio, the top three holdings, and market musings. Before I get started with the portfolio, please allow me to digress a bit to talk about investing lessons from mountain climbing, specifically the 8,000ers.

****

We All Have Our Own Annapurna: On a hot summer day in Rockford, IL, after a grueling three-set Boys-18 tennis match that my son won, I decided to take him to the local public library to cool down before getting back on the court for his next match. Flipping through an old stack of *Rockford Register Star*, a local newspaper, an article celebrating a local son caught my attention. "Ed Viesturs makes history on highest peaks" (July 21, 2013). Ed is the only American to have reached the summit of all fourteen 8,000-meter (26,247 feet) peaks in the world...without the aid of supplemental oxygen. I am not sure why, but I was immediately intrigued by this man and his many accomplishments. Perhaps it is because, as Robert Pirsig says in his wonderful book *Zen and the Art of Motorcycle Maintenance*, "The allegory of a physical mountain for the spiritual one that stands between each soul and its goal is an easy and natural one to make."

While Mt. Everest is the tallest mountain in the world at 8,848 meters (29,029 feet), 13 other mountains tower more than 8,000 meters above sea level; all of them are in the Himalayan and Karakoram Mountain ranges in Asia (see Appendix 1). Maurice Herzog, a French alpinist, reached the summit of Annapurna, 10th tallest, in 1950 and wrote a book by the same name. *Annapurna* is said to be the most influential book on mountain climbing ever written. Ed Viesturs was inspired by this book.

Rockford, IL, located about 90 miles west of Chicago, IL, is the epitome of a Euclidean plane, with no hill or bump within a 100-mile radius. Growing up in this flatland, Ed decided that he wanted to climb Mt. Everest. More than 10 years after moving to Seattle, WA, for college, Ed accomplished his dream of summitting Mt. Everest. During his 18-year career, he reached the summit of Mt. Everest five times, three of which were without supplemental oxygen. On May 12, 2005, Ed Viesturs capped his climbing career with the ascent of Annapurna, which had started it all for him as a high-school student in Rockford, IL, and happens to be one of the world's most treacherous peaks.

Ed's philosophy, his approach to the craft of mountain climbing, and his strategy for accomplishing his "Endeavor 8,000"[1] goals, resonated well with me and how I think about the craft of investing. For example, when Starbucks asked for his motto that it would print on eight million coffee cups, he described his philosophy as follows:

> *I've learned in climbing that you don't "conquer" anything. Mountains are not conquered and should be treated with respect and humility. If we take what the mountain gives, have patience and desire, and are prepared, then the mountains will permit us to reach their highest peaks. I believe a lot of things are like that in life.*

Intense preparation and patience are tools I deploy in managing the investment portfolio.

Fortunately, Ed is a prolific writer (he has written three books about his experience as a mountain climber) and spends his time as a motivational speaker covering topics such as risk management and decision-making under pressure[2]. While there are many lessons in these materials, I would summarize his principles down to the following:

- **Safety Before Success.** In 2002, after his second unsuccessful attempt at summitting Annapurna, he said, "In our own evaluation, the level of risk was increasing and the margin of safety was decreasing. There are some risks involved when you climb these mountains, but …it's ultra-important that you have a very conservative attitude."
- **Independent Judgment.** Listening to the mountain is a unique skill that helped him avoid potential disasters over the years. He said:

  > *Among my 30 expeditions, I've reached the summits of 8,000ers an even 20 times. But that means that I had to—or decided it was only safe to—turn back 10 times…And four of those 10 turnarounds came when I was within 350 vertical feet of the top. I'm also proud of the fact that I have never turned around because of lack of preparation, strength, or desire. It was always the conditions that caused me to pause and retreat.*

- **Risk Management.** In 1996, a statistically minded journalist had concluded that, based on conditional probability, Ed's risk of death increased with every attempt at an 8,000-meter summit, just as risk rises in a game of Russian roulette with a gun with one bullet and six chambers. Ed responded to the journalist through his wonderful book *No Shortcuts to the Top* that "…the odds do not accumulate after each climb, as they do for a set of successive pulls of a trigger. Each expedition is separate from the previous one. If I learn something from a previous climb and become a better mountaineer—smarter, faster, stronger, more efficient—then the next climb will be safer. The risk actually goes down."

---

[1] In the mid-1990s, after summitting three peaks, Ed set a goal of summitting the other 11 and called it "Endeavor 8,000."

[2] https://www.youtube.com/watch?v=rSohhWOP0P0

These are some of the core tenets of my own investing style at SVN Capital. Margin of safety is the focus as I consider the business risk, financial leverage risk, and valuation risk of any investment. Even after spending several months researching a particular investment, if I'm not convinced about the opportunity, then I "turn around" and get back to base camp. Fortunately, knowledge gained from "climbing" (researching) a business is cumulative and helps me become a better "climber" (analyst and portfolio manager).

In the last sentence of the book *Annapurna*, Maurice Herzog says, "**We all have our own Annapurna**." It is a great metaphor for life, which is a series of peaks and valleys. It certainly is for mine and SVN Capital's.

****

After a quiet second half of 2020, I added two new businesses to the portfolio in 2021. Both are outside the US. One of the unique aspects of our fund is our ability to invest in great businesses around the world. Irrespective of the geography, I look for the following features in our portfolio companies:

- businesses I can understand;
- high returns on incremental capital and the ability to reinvest at a similar or better rate;
- honest, competent management teams with "skin in the game"; and
- reasonable valuations.

The first one is Evolution AB in Stockholm, Sweden. In late March 2021, I wrote about this company which you can find here.

Evolution AB (OM: EVO): Stockholm, Sweden-based Evolution is the leading Business-to-Business (B2B) provider of "live" casino systems to operators. Here are a couple of updates to my March write-up.

First, in April 2021, the company made a €460 million acquisition of Australia-based Big Time Gaming Pty Ltd. While the size of the deal is small relative to the size of EVO, this acquisition is expected to further widen its lead in the slots market. Evolution is already a behemoth in its space, but it's growing at breakneck speed. Consider the following two data points: 1) the three-year average free cash flow growth was 90%; and 2) free cash flow in 2020 was higher than the revenue it generated in 2018.

Second, as a Malta-based operation, EVO currently incurs ~5% in taxes. Under the guidance of the Biden administration, a global minimum tax of ~15% has gained momentum. As it takes shape, and as the company expands in the US, I expect the company's taxes to go up. Despite the potential tax headwind, I believe EVO has terrific growth potential—particularly in the US and Asia—and is trading at an attractive valuation relative to its long-term earnings potential.

Next is Tel Aviv, Israel-based **Automatic Bank Services Limited (TASE: SHVA)**. Electronic payment systems are some of the most profitable businesses in the world. Businesses that act as toll booths, collecting from the trafficking commuters and needing little to no capital, generate high returns; Visa (V) and Mastercard (MA) are two good examples. Automatic Bank Services Limited (SHVA), trading on the Tel Aviv stock exchange in Israel, is the only card network operator in Israel, much like V and MA here in the US. Thanks to my friends Pat Srinivas, a fellow University of Chicago alum, for bringing this idea to my attention, and Adi Soglowek in Tel Aviv, Israel, for helping me with due diligence during the pandemic.

The company was founded in 1978 as a private company but was controlled by five Israeli banks. Due to certain regulatory changes in Israel, these banks were required to sell down their interest to a maximum of only 10% of the outstanding shares. SHVA was taken public in 2019, with four Israeli banks owning 10% each. Later, V and MA bought 10% each. As a result of this structural change, public float remains low.

The following description of the business model of V and MA from 2014 accurately captures the business model of SHVA today[3].

> *At their core, these businesses act as a "toll road" upon which any card-based payment has to "travel": transaction data has to be "switched" (authorized, cleared, settled) by the network before it is passed between acquirer/issuer/merchant. As the number of transactions in a (successful) card network increases exponentially, the operator earns an increasing return on the (relatively) fixed investment which cleared the network in the first place.*

To act as the "toll booth" in the Israeli payment ecosystem, SHVA collects transaction-based fees (charges assessed per transaction; 2 Agorot/transaction[4]) and infrastructure-based fees (charges assessed to connect the point-of-sale terminals in shops to the system; 15 or 19 Shekels/month/terminal).

Israel is a small country with only 9.0 million people; but it has an advanced economy GDP per capita of $43,600 and a growth rate of approximately 3.5% per year. However, when it comes to cash vs. credit card spending, Israelis exhibit a developing-economy preference for Shekels over cards. For example, only 38% of transaction volume in Israel is handled through credit and debit cards, compared to the US where almost 70% of transaction volume is card based. I believe there is significant room for credit and debit card usage to increase in Israel and for SHVA to collect more tolls.

[3] Scuttlebutt Investor: The Toll Booth Businesses of Visa and Mastercard, September 13, 2014.
[4] Israeli currency is the shekel represented as ILS; 1 shekel = 100 agorot; 1 USD ~= 3.25 ILS as of this letter.

Following are some of the reasons I believe the stock continues to trade at an attractive valuation.

- SHVA is a microcap company with a low public float, as referenced above.
- SHVA trades on the Tel Aviv stock exchange and files its financials in Hebrew before they get translated into English several weeks/months later.
- Mr. Moshe Wolf (CEO, 64 years of age) has announced his retirement and the company has yet to announce his successor.

Despite these issues, I like the monopoly toll collector with a significant growth tailwind, generating a healthy return on capital while maintaining a balance sheet with excess cash.

****

Portfolio: What a difference a year makes! In the midyear 2020 letter I said:

> *At midyear, the best that can be said is that the first great wave of the pandemic appears to be abating, and the economy is slowly reopening. We are here, of course, as a result of the worst global public health crisis in a century—in response to which, the world locked down, putting its economy into a kind of medically induced coma.*

While not fully recovered, the global economy is certainly out of the medically induced coma as of midyear 2021. It feels good to be able to meet with family and friends again. It is quite satisfying to see most of our portfolio companies adapt well to the new reality and show improved operating results. Standouts include **Newell Brands Inc.**, which *improved its free cash flow in 2020 by ~50%*, Italy-based **DiaSorin S.p.A.** (see below), and **KKR & Co. Inc.** (see below).

A few of our companies made major capital commitments in 2020 through acquisitions. **DiaSorin** announced the acquisition of *Luminex Corporation for $2.1 billion in April 2021*, **Evolution** announced the acquisition of *NetEnt AB for $2.4 billion in June 2020*, **Intuit** announced the acquisition of *Credit Karma for $7.8 billion in February 2020*, and **KKR** acquired *Global Atlantic Financial Group for $4.7 billion in July 2020*. Poland-based **LiveChat Software** returned *~100% of its free cash flow as dividends*, and **Verisign** returned *~100% of its free cash flow through share repurchases*.

Travel is one area that has not fully recovered but is poised to do well as economies reopen. Two companies within our portfolio felt the brunt of the pandemic: UK-based **InterContinental Hotels Group,** which franchises Holiday Inn and other branded hotels; and **HEICO Corporation** (see below), whose Flight Services Group segment sells spare parts to airlines. Overall, our portfolio of businesses did exceptionally well in the post-pandemic world, and the trend continues.

<u>We currently own 11 investments. Cash is less than 1.0%.</u>

The top five holdings account for approximately 60% of the portfolio. Our portfolio is concentrated and geographically diversified. 55% of our portfolio is listed in the US, while the rest is spread among Sweden, Italy, Poland, Israel, and the UK. Of course, what matters is not where these companies

are listed, but where they generate their revenue and incur costs. In aggregate, our portfolio companies generate approximately 50% of their revenue in North America while the rest is geographically spread even more widely than the countries listed above.

Here is a brief overview of three of the top five positions, arranged alphabetically:

DiaSorin S.p.A. (BIT: DIA): Turin, Italy-based DiaSorin is a global leader in the laboratory diagnostics market. In vitro diagnostics are tests done to detect the presence of certain molecules that are indicative of certain diseases in a patient's biological fluids such as blood, urine, and cerebrospinal fluid. Such fluids are put in a test tube (hence the term "in vitro") with some chemical substances to create a reaction. DiaSorin provides such reagent kits (chemical substances) for conducting more than 130 different tests in laboratories and hospitals. The company is active in two areas of in vitro diagnostics: *Immunodiagnostics (~75% of revenue)*, which detects particular disease molecules with the use of antibodies, and *Molecular Diagnostics (~15% of revenue)*, which detects the DNA and RNA that are specific to certain diseases.

DiaSorin is a highly profitable diagnostics company that has doubled its annual revenue and more than tripled its free cash flow while generating ~15% cash return on capital over the last 10 years. However, with the onset of the global pandemic, most diagnostic testing ceased except for COVID-19. DiaSorin, an innovative and opportunistic company, developed two molecular diagnostic tests and three immunodiagnostic tests for COVID-19 in 2020. While the average revenue growth over the previous nine years was 6.5%, in 2020, the company grew its revenue by almost 25% and generated cash return on capital of 18.2%, much of it from COVID-19 tests! The market reacted favorably, and the stock was up ~46% in 2020.

However, in 2021, DiaSorin has been the worst performer in the portfolio declining by approximately 6.0% YTD. Perhaps the market's reaction is due to businesses and countries reopening, as well as some of its competitors releasing their own COVID-19 tests. However, unlike some of its COVID-testing competitors, DiaSorin has a diversified portfolio of tests for diseases like latent tuberculosis, the hepatitis variants, Lyme Disease, and many more. Management has consistently highlighted the company's capabilities well beyond COVID-19. Historically, the company has grown through acquisitions and partnerships. In April 2021, the company announced its biggest acquisition to date—Luminex Corporation (LMNX) for $2.1 billion in cash. This acquisition, expected to close in Q3 2021, will bulk up its multiplex molecular diagnostics segment, which I believe will be a strong driver in the future. I have added to the name opportunistically during the year.

HEICO Corporation (HEI): HEICO is a diversified aerospace and defense component supplier. It operates through two segments. In the Flight Support Group (FSG) segment, it manufactures aircraft parts for sale directly into the aftermarket via third-party parts manufacturer approval (PMA). In the Electronics Technologies Group (ETG), it sells to defense, space, and healthcare companies.

I added HEICO to the portfolio during the early stages of the pandemic in 2020 and wrote about it in the mid-year 2020 letter, which you can find here. Before the pandemic, the FSG segment, which sells directly to airlines and maintenance, repair, and operations, was the bigger of the two segments, generating almost 60% of total revenue. With the onset of the pandemic, this segment was hit hard. In the most recent quarter, which ended on April 30, 2021, the company announced an improvement in revenue and margins in this segment, much of it due to increased flight activity as vaccinated individuals resumed leisure travel.

As more airlines nurse their financial wounds on their way to recovery, I expect them to find HEICO's products, sold at a significant discount to original equipment manufacturers' cost, to be attractive.

Historically, the company has grown through acquisitions; it completed one in 2021 and has completed five in the past year. In this pandemic-impacted travel market, the company is being selective and is finding high-quality targets of various sizes.

Even though the stock has almost doubled from its low during the pandemic, I find the PMA business, unique acquisition strategy of not acquiring 100% of the target, decentralized operations, valuation, and cash-flow-focused culture of this owner-operated company to be attractive.

KKR &Co. Inc. (KKR): KKR is one of the largest alternative asset managers in the world, with $367 billion in assets under management, but it is better known for its private equity business which is only one of 26 strategies that it manages.

Asset management has been compared to farming: raise capital, put it to work, cultivate, and then harvest. While the fund is operating (putting it to work and cultivating, which is usually seven to 10 years), KKR gets a management fee (~2% of the fund/year) and an incentive fee (cultivating and harvesting, ~20% of profits over a specific hurdle rate). The bigger the fund and the better the performance, KKR gets to collect a healthy management and incentive fee.

The alternative asset management industry, which is currently $14 trillion, has grown at 11% CAGR[5] over the last six years, while KKR has grown at almost 22% over the same period. One of the reasons for the industry's growth is due to the superior return profile and lower reported volatility when compared to traditional public equities. One of the reasons for KKR's growth is its ability to execute each one of the steps in the farming analogy above, and to do so well. For example, KKR expects to raise more than $100 billion in 2021/2022. In terms of "cultivating," KKR announced the acquisition of Global Atlantic, a leader in annuities, for $4.7 billion, increasing its permanent capital base. I expect this owner-operated asset manager to continue growing for a long time to come.

A typical strategy takes about seven to 10 years to reach maturity before it starts generating a healthy incentive fee. The management fee has grown at a 15% CAGR over the last six years,

[5] Source: PwC, Prequin, Pinebridge Research and S&P Global.

while the incentive fee has grown at a 42% CAGR over the last three years. At KKR, almost 50% of the strategies are less than six years old, setting up a significant fee-growth opportunity in the future.

Even though the stock has gone up 3x since the pandemic in 2020, I believe KKR is one of the most attractive businesses within the portfolio; it has a significant asset growth tailwind, immense opportunities to grow many of the existing strategies to scale, and to reinvest in new strategies.

****

Market Musings: Inflation is the current bugaboo as it relates to investing. According to the media, it is the next "crisis" that will lead the equity market to the next crash. With equity markets, there is always an impending crisis, never a period of peace and quiet. We have had a few of these crises over the last couple of years: COVID-19, the presidential election, oil price decline…into negative territory, excessive monetary stimulus, excessive fiscal stimulus, and much more. Since the pain of a loss is twice as intense as the pleasure of a gain, and because the media is ever-present in our lives to remind us about the upcoming crisis, it is difficult to not worry about it. After all, the S&P 500 stayed flat over 11 years from 1967 to 1978 **(Oct 1967: 95.66…Dec 1978: 96.11)**, one of the periods of sustained inflation, bordering on hyperinflation, in the country's history. The topic has seeped into many of my recent conversations with investors and friends.

No country can continue to grow its debt faster than its GDP growth rate. Since the financial crisis, the Fed has been trying to shoot for 2% inflation while keeping interest rates close to zero. We are in the midst of an unprecedented experiment in both fiscal and monetary policy, the outcome of which remains impossible to forecast. The possibility that we have overstimulated the economy was highlighted this spring by a significant increase in prices across commodities, homes, and much more. After a sharp rise in the bellwether 10-year US Treasury rate from 0.50% in 2020 to 1.75% by spring 2021, it has now retreated to around 1.40%.

With prices rising followed by interest rates, many say that the future is here and inflation has arrived. Some even say that it is not temporary. For me, it remains an open question whether the recent increase in prices is merely a response to pent-up demand, or whether it will persist and usher out the low-inflation environment to which the markets have grown accustomed. One does not want to read too much into short-term phenomena like these.

But first, how does the stock market react in an inflationary period? The simple answer is, "not well." Ben Carlson, a prolific writer on financial markets observed the following[6]:

[6] Ben Carlson: www.awealthofcommonsense.com, Mar 22, 2021.

Inflation Is Not Great For the Stock Market

Annual returns for the S&P 500: 1928-2020

Rising Inflation	Falling Inflation	Inflation >3%	Inflation <3%
6.7%	16.5%	6.3%	15.7%

TABLE: BEN CARLSON • SOURCE: NYU

FORTUNE

Why is that? In its simplest terms, the value of any business is the sum of all its future cash flows, discounted back to the present at an assumed discount rate. This discount rate is a function of interest rates, which ultimately respond to inflation. The same stream of future earnings is worth more in a low-rate, low-inflation environment than in a higher one.

Stock prices come under pressure as inflation rises for two reasons: 1) the possible lag between the time when companies' costs rise and when they can raise prices and pass it to their customers; or 2) the increase in the discount rate at which the market discounts their future cash flows.

So, how do we hedge against inflation? Warren Buffett has written extensively on this topic and described inflation as a "gigantic corporate tapeworm." In a *FORTUNE* article from May 1977, he said, "The arithmetic makes it plain that inflation is a far more devastating tax than anything that has been enacted by our legislatures." His recommendation is to own "wonderful" businesses, defined as those that do not need much capital for future growth (capital-light) or good brands that can maintain their price discipline.

Our portfolio is well-endowed with capital-light businesses. For example, all the software businesses—Automatic Bank Services (SHVA) in Israel, Evolution AB (EVO) in Sweden, LiveChat Software (LVC) in Poland, and Intuit (INTU) here in the US—are capital-light. EVO and INTU also happen to be popular brands in their respective industries. Most of the companies that I am currently researching also happen to be capital-light. A final point on this topic is that great companies wage constant war against rising costs by innovating and becoming more productive. That, I believe, is ultimately the best hedge against inflation.

****

I am excited about the collection of quality businesses we own; and I am just as excited about many of the quality businesses I am currently evaluating. I continue to remain patient and invest with a long-time horizon.

Please be in touch with any and all questions and concerns. In the meantime, thank you for giving me the privilege of serving you.

Sincerely,

Shreekkanth ("Shree") Viswanathan

****

Disclaimers

The information presented in this investor letter is confidential and specifically prepared to provide information to current and prospective investors in SVN Capital. This letter does not purport to be all-inclusive or to contain all of the information a prospective or existing investor may desire. The information herein is not intended to be used as a general guide to investors or as a source of any specific investment recommendations. SVN Capital expressly disclaims making any express or implied warranties with respect to the fitness, accuracy, or completeness of the information contained herein for any particular usage, application, or purpose.

No assurance can be given that the objectives of a particular investment will be achieved or that an investor will receive a return of all or part of his or her investment. All investments involve the risk of loss, including the loss of principal. In no event shall SVN Capital be responsible or liable for the correctness of any material used herein or for any damage or lost opportunities resulting from the use of such material.

SVN Capital is a Registered Investment Advisor registered in Illinois. This communication does not constitute a recommendation to buy, sell, or hold any investment securities. SVN Capital maintains a long-term investment approach and as such discussion of individual companies herein is intended to provide investors with material updates to portfolio positions, regardless of performance, and should not be construed as an indication of a successful investment.

****

APPENDIX 1

WORLD'S 14 HIGHEST PEAKS

Source: www.edviesturs.com

Mountain	Country	Summit
Everest	China / Nepal	8,848
K2	Pakistan / China	8,611
Kangchenjunga	Nepal / India	8,586
Lhotse	China / Nepal	8,516
Makalu	China / Nepal	8,485
Cho Oyu	China / Nepal	8,201
Dhaulagiri I	Nepal	8,167
Manaslu	Nepal	8,163
Nanga Parbat	Pakistan	8,126
Annapurna I	Nepal	8,091
Gasherbrum I	China / Pakistan	8,080
Broad Peak	China / Pakistan	8,051
Gasherbrum II	China / Pakistan	8,034
Shishapangma	China	8,027

Source: Wikipedia