



Rowan Street Q2 2022 Letter

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Summary

- Rowan Street Capital, LLC is a global value-oriented investment firm that is focused on high conviction, high concentration investments with a long-term time horizon. We seek to invest in strong businesses, managed by good people that we can purchase at discounted prices in relation to their intrinsic value.
- You only need a few best ideas, few extraordinary businesses in your life. The key is to stick with them as long as they remain extraordinary.
- Over many years, we found that our sole focus should be on identifying and partnering with visionary CEOs and best entrepreneurs in the world, preferably in the earlier-to-mid stages of their careers.
- We believe in playing the long-term game with long-term people.



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The Next Chapter for Rowan Street

Dear Partners,

This year we celebrated 7 years since the founding of Rowan Street Capital. In our [2020 year-end letter](#) we shared our story with you and the evolution of our investment approach. Investing is a journey filled with many ups and downs and countless lessons. As they say, investing cannot be taught, it has to be experienced.

On Wall Street and in today's world of information overload, you are constantly bombarded with new ideas that constantly appear "sexier" than what you already know well or the stock is going up much faster than the stocks in your portfolio. If you really think about it, you only need a few best ideas, few extraordinary businesses in your life. The key is to stick with them as long as they remain extraordinary. This is truly the path to extraordinary wealth! And no one knows this better than Charlie - [here is one of my favorite videos](#) of him where he explains this simple concept.

The difficult part here, of course, is saying NO to almost all other ideas because they distract from your best ideas and detract from your process of compounding. Here too, though, there is quite a balancing act. You want to be able to say NO in order to keep your focus on your best ideas, but at the same time you want to be open-minded to learning about new businesses and developments and expanding that circle of competence over time.

Unfortunately, this simple realization came to me after many years of investing. About five years ago, we decided to refocus our efforts into just **owning a few extraordinary businesses** that are run by talented, passionate and honest managers, who are also business owners. Just like rare diamonds or truly special and unique pieces of art, extraordinary businesses and management teams are very rare, and once you find them and understand their magic, you tend to hold on to them. Selling one just because it doubled in price over the course of a year or two does not make much sense; neither does it make sense to sell just because the stock price is dropping. First, you have to pay the capital gains tax. Second, the likelihood of finding another gem that is as good as the one you already own, and finding one that is selling for a reasonable price (true gems are never without a huge fan base) is relatively low. Third, we found that it takes quite a bit of time to truly get to know the management and understand "the magic" of the company. Getting to know companies is very similar to getting to know people. They may give you a great first impression, but it takes a while before you get to know the true person deep down inside. It is very rare to like something just as much or even more after you have owned it for 3 years. That's why we always say that conviction is a lot like love and trust, it can only be built over time.

Which pond do we fish in for extraordinary businesses?

We found that they can be absolutely anywhere, in any industry, geographical location and come in any size. What we discovered in our 20+ years of investing, is that extraordinary businesses are always built by extraordinary people. These people are super rare! They possess special qualities, personality traits and a winner's mentality. They are passionate entrepreneurs that are absolutely obsessive in their belief and their devotion to their vision for the company that they are building, and they are constantly building and evolving, they never rest on their laurels.

Let me give you a few examples. A couple of years ago, I read a book called "The Airbnb Story". Here are a two quotes from this great book that help illustrate what I'm talking about:

- Brian Chesky's (Founder/CEO) fanatical belief in and devotion to what he sees as Airbnb's higher purpose seem to be the things that drive him more than anything else. He believes in home sharing "down to his toes" and he talks about the company's mission, "belonging anywhere," relentlessly, not as a CEO talking up the tagline that sells the product his company makes, but as the reason he was truly put on this earth!
- Really, honestly. I have seen so many different founders-literally, thousands. And I can tell the opportunists from the believers. It's way beyond money or even fame for him. For that reason, Chesky may not be cut out for just any CEO role. He's the kind of leader who leads people to do things that he himself believes in. You could not hire him as the CEO of some random company. Warren Buffett sensed this, too. "He feels it all the way through. I think he would be doing what he's doing if he didn't get paid a dime for it."

This kind of mentality and passion drives a unique and special energy, which is contagious. It turns employees into believers and attracts the right people, talents and resources into the company. It instills the certain kind of a "winners DNA" that runs deep in the company's founding roots. This stuff is very intangible and a lot of times you cannot see this in a company's financials or by running a screen on your Bloomberg terminal. Humans have a tendency to want to quantify everything that is meaningful. But so much of what's meaningful is based on human spirit and is unquantifiable. That is why long-term investing is more of an Art rather than Science.

Let me give you another example. The mentality of a passionate Founder/CEO drives a completely different thought process and decision-making that makes all the difference. This is a quote by Brian Armstrong, Founder and CEO of Coinbase ([COIN](#)):

"I can speak with some authority and say we are not going to do that because this is not why I started the company - I don't have to give any other justification. Rather than the professional CEO that comes in that is accountable to Wall Street and quarterly earnings may start thinking about the company differently. One of the most scarce things in companies today is risk tolerance. For example, take Tesla vs. Waymo. Tesla launched self-driving cars while Google didn't. The reason is the founder-CEO (Elon Musk) said that I care enough about the mission that we are ready and we are gonna go for it. Whether a professional CEO is thinking about his/her career trajectory, the founder CEO doesn't care about the next job and only cares about the mission."

The following quote is from one of my favorite books "100 Baggers" written Christopher Meyer, which drives the same point home:

"People (owner-operators) running these companies are in control, so when we experience a drawdown like 2008, that's precisely when they are going to deploy cash because opportunities are so rich and that's when you want to be spending money. Compare this behavior to agent-operated companies. They loathe spending cash or taking on debt in a highly volatile environment. An agent-operator is so fearful about how that will be perceived by the public and the board and how it may impact his/her career prospects.

If you study all the great Founders/CEOs like Steve Jobs, Bill Gates, Mark Zuckerberg, Elon Musk, Warren Buffet, Larry Ellison, Brian Chesky, Reed Hastings, Marc Banioff, Jim Walton and Phil Knight, just to name a few, you will find many similarities in how they ran their businesses and in how they make decisions. What also distinguishes them is they remained majority shareholders (owners) of their companies throughout their careers. While every single founder listed above has experienced their company stock dropping 50% and much more on several occasions, they continued to hold on to every single share - that is what true business owners do, they continue to own and compound their wealth over time. In contrast to agent-operators (hired CEOs) that usually own less than 1% of company stock and consistently sell for "financial planning" purposes.

One question that we always get...

Since 2017, you have been heavily invested in digital platforms and in growth-oriented innovative and disruptive firms. At the same time, you look for durable competitive advantages in companies and are looking to own them for the next 5-10+ years. Technology is a rapidly evolving space and it's very hard to predict who gets disrupted, who survives and who gets to be the winner. Why not stay with the safer, predictable companies like you did in the early days?

Well, the world has changed quite a bit from the one 50-60 years ago when Warren Buffett was starting to build his empire. The enduring moats of the 20th century were the widely-known brands like Coca-Cola ([KO](#)), American Express ([AXP](#)), See's Candies, Wrigley's or low-cost producers like Geico, Walmart ([WMT](#)), Costco ([COST](#)). These businesses were highly predictable. Like Warren Buffet once said: "The internet is not going to change how people chew gum." Well, who could have predicted that the internet disrupted traditional retailing and drove exponential growth in e-commerce, which hugely affected the traffic in the check-out lines where most chewing gum sales occurred?

We live in the 21st century of disruptive innovation and digital transformation. Change is the driving force for creative destruction and value creation! Thus, we need to spend more and more time understanding change and the people behind it rather than trying to find businesses that are unlikely to change over the next 5-10+ years. We also believe that the very definition of technology and the "tech sector" as Wall Street likes to coin it does not make sense anymore. Every single industry out there is being disrupted and if you are not a technologically-focused company, you are guaranteed to be out of business sooner or later. The pandemic of 2020-21 actually was a preview of what's coming. Traditionally "safe" dividends and predictable "earnings" are no longer safe and predictable!

- **Amazon** ([AMZN](#)) disrupted the traditional retail model (was not profitable until 2016 because it heavily reinvested its gross profits into widening its economic moat)
- **Netflix** ([NFLX](#)) disrupted Hollywood, Cable TV and movie theatres (cash flow negative until 2020; reinvested \$92 billion over past 10 yrs into content)
- **Google** ([GOOGL](#), [GOOG](#)) and **Facebook** ([META](#)) disrupted the advertising industry, traditional media (newspapers, TV)
- **Airbnb** ([ABNB](#)) disrupted the hotel and hospitality industry
- **Spotify** ([SPOT](#)) disrupted the music industry and brought it back to life via streaming
- **Tesla** ([TSLA](#)) disrupted the auto and transportation industry
- **Uber** ([UBER](#)) and **Lyft** ([LYFT](#)) disrupted the traditional taxi industry
- **Apple** ([AAPL](#)) disrupted everything (the way we spend our time, conduct business, travel, communicate)
- **Zoom** ([ZM](#)), **Slack** and **Snowflake** ([SNOW](#)) disrupting the way we work

These are just a few examples of many disruptions going on right now. We cannot stop them, we can only embrace them, study them and be a part of them!

Who We Are

It is common knowledge that the average return in the U.S. equity asset category over the last century has been in the neighborhood of 9-10%. It just so happens that this figure correlates with the rate of return on the owner's capital of the typical U.S. company. We posited from this observation that our return on an asset would therefore approximate the return on the owner's capital, absent any distributions, and assuming a constant valuation. And since our stated goal is to compound our partners' capital at double-digit returns over time, we needed to identify this group of superior businesses, which earn double-digit rates of return on their owner's capital.

We have identified that investing in a few "extraordinary" businesses, as we define them, is the BEST way to achieve our goal. And to tie this back to our earlier discussion, extraordinary businesses are always built by extraordinary, passionate and almost fanatical people. These people are winners, missionaries and exhibit true passion for their vision of what they are building, and they believe in that with every cell in their body.

Over many years, as we refined our investment philosophy, we found that our sole focus should be on identifying and partnering with these visionary CEOs and best entrepreneurs in the world, preferably in the earlier-to-mid stages of their careers. We are not venture investors and never just bet on pure ideas and vision. We like to bet on entrepreneurs that have already proven their abilities to execute against all odds. We like to see evidence of the strong competitive advantages forming. We focus all our efforts and energy on winners - companies that either are already #1 or have strong potential in becoming #1 in their respective industries. We found that this particular style and approach to investing fits who we are the best, and thus will create the most value for our investors over time.

The process of identifying these requires intense multi-year research effort that dives deep into the DNA and the culture of the company, understanding the roots of the Founder/CEO, their motivations and mentality and the true source of their drive. These things are very intangible, but we believe they tell us the story that no financial statements could. By any means, this doesn't mean that we don't pay attention to numbers. We definitely do, but numbers to us are simply a longer-term confirmation that our original thesis is correct and that the management is executing against their strategy, and are in-fact, doing exactly what they promised.

The Next Chapter for Rowan Street

To summarize, over the next 10+ years we will focus every bit of our time and energy on being true long-term business partners with the most extraordinary entrepreneurs in the world, who have already proven their ability to execute against their vision and strategy. We have been transitioning the Rowan portfolio to this strategy over the past 4 years. In our top 4 positions in the fund (Spotify, Meta, Trade Desk, Topicus) we have identified these "extraordinary" businesses that we talked about, and we believe they are run by some of the most passionate and missionary Founder CEOs in the world:



Daniel Ek, Spotify Founder and CEO

Visionary entrepreneur who set out to reimagine the music industry and to provide a better way for both artists and consumers to benefit from the digital transformation of the music industry. He beat Apple, Amazon, Pandora to become the largest music streaming platform. Daniel owns 17% of the company, and his co-founder Martin Lorentzon owns 11%.

When Spotify went public in 2018, they were a music-streaming company, but they have evolved dramatically over the last four years. Daniel Ek's ambitions did not stop at music, as Spotify is focused on building the global audio infrastructure of the Internet. They are continuing to expand and build on the strong foundation in music, applying their learnings and leveraging their leading 420 million user base to move into new verticals like podcasting and audiobooks, ultimately broadening their value proposition. As a result, they are building a more resilient business. For example, in three years, Spotify has gone from basically zero to being the market leader in podcasting - a business that we believe will enable a large influx of high-margin revenue through advertising and direct monetization. Just as video content is a trillion-dollar opportunity, we view audio through a similar lens. Spotify has the potential to become the Google of audio.

We believe Spotify is one of the most relevant digital platforms in existence today, as it has transformed itself to a fully-fledged platform where artists and creators can create, engage, and earn. A platform fueled by subscription, advertising and creator service models, applied to music, podcasts, audiobooks and more. At a current market value of just \$20 billion, we think Wall Street is not appreciating the true long-term potential of the Spotify Machine.



Mark Zuckerberg, Founder and CEO of Meta

Mark does not need an introduction. We started buying Facebook shares back in 2018 when the stock was very depressed as Facebook was dealing with a long 'dirty-laundry' list of challenges. We were convinced that Facebook remains an extraordinary business with incredible moat (2.9B users), and they still have tons of opportunities to profitably reinvest their capital. We have been very impressed with how Zuck & Co. handled a long list of challenges over the past few years and managed to keep growing and innovating! There are not many CEOs in the world that are more committed to the long term vision of his company than Zuck. We encourage you to read his recent [Founders Letter](#) where Mark has outlined his vision (next chapter for the internet and next chapter for his company) - its hugely inspiring.



Jeff Green, Founder/CEO of Trade Desk

Jeff has been on a mission to make data-driven advertising as ubiquitous as electronic trading in equities ever since he founded the Trade Desk in 2009.

Since day one, his goal was to create a platform where advertisers could value media inventory through data-driven decisions. With the ability to buy and sell advertising inventory electronically or programmatically, advertisers could use data to make better decisions on what, when, and whom to show an ad impression. Jeff owns 10% of the company.

Jeff has built Trade Desk into a leader in ad tech, with a record of \$6.2 billion spend on the platform in 2021, up 6x since 2016. Revenues are estimated to hit \$1.6 billion in 2022, up almost 8x since 2016.



Total Specific Solutions (TSS) was an operating group of Constellation Software (CSU:TSX) that was spun out in early-2020.

Mark Leonard started Constellation Software ([CSU](#)) in 1995. Since then, he's been on a 27-year acquisition bender of vertical market software (VMS) companies. Today, CSU is a collection of independently managed VMS businesses across dozens of verticals: hospitality, education, healthcare, banking, marine management, libraries, transportation, publishing, utilities, logistics, construction, retail... and the list goes on. **Mark Leonard is one of the best compounders of capital in history.** CSU stock is up 10,168% since it went public in 2006, which translates to 34% annual return. There are few public equities that can match this track record.

The newly formed entity is called Topicus (CVE: TOI), which trades on the Canadian exchange. Topicus, operating in European markets, is effectively a carbon copy of CSU, with a nearly identical decentralized organizational structure, decentralized M&A process, sticky customers, and strong reputation as a perpetual owner of VMS businesses. Even the board of directors has meaningful overlap.

In summary, all four entrepreneurs we discussed above have proven their ability to execute against all odds and they have built exceptional companies that are the leaders in their respective industries. Given a long-term investment horizon that we employ, we believe these leaders will continue to create significant shareholder value, and we expect to see significant appreciation in their stock prices over the next 3-5 years.

New Position

We have taken advantage of the recent downturn in the market to add another position to the fund that is consistent with our goal of partnering with the world's most extraordinary businesses and entrepreneurs.



Tobias Lutke, Shopify ([SHOP](#)) Founder and CEO

When Tobias Lütke opened an online snowboarding store in 2004, he realized how painfully cumbersome e-commerce software was. So he decided to create Shopify - a platform that made it easy for anyone to open up an online store.

Tobi has built Shopify into one of the most popular e-commerce platforms in the world, with \$175 billion in GMV (Gross Merchandise Value) and \$4.6 billion in revenues in 2021. SHOP went public in 2015, when revenues were just lightly above \$200 million, and the stock is up 1,233% since its IPO. Shopify stock peaked in November 2021 (traded at astronomical 47x sales), which coincided with peak enthusiasm for the tech-driven, "stay-home" stocks. Since then, the stock is down almost 80% and is currently trading at just 6x 2023E sales. We believe that Mr. Market is offering us an exceptional value, at current price levels, for an exceptional company led by a very talented, visionary founder/CEO.

Why?

Just like the entrepreneurs that we look to partner with, we are deeply passionate about what we do and where we are looking to take Rowan Street over the next 10-20 years. Building a fund like Rowan Street has been my dream ever since I read "The Warren Buffett Way" by Robert Hagstrom back when I was still in college.

I believe with every cell in my body that the past 7 years since we started the fund has been a set-up for what's coming. The experience and the lessons we had learned have given us a laser sharp focus. We know exactly where we are looking to "steer this ship." This is not just a job to us. This is our life's purpose - doing what we do at Rowan Street gets us out of bed in the morning. Our goal is to be the best, to establish one of the best and longest track records in the 21st century. And this journey and the achievement of this very audacious goal will not be possible without the trust of our like-minded and patient partners.

This ties back to our original vision, which we outlined in our [very first letter](#):

"Our vision is to build something special at Rowan Street Capital, LLC where our partners can visualize themselves as part owners of a business they expect to stay with for a long time, just like they would if they owned a rental property or a farm in partnership with members of their family. The goal is to build a portfolio of great companies that will compound our partners' family wealth at double digit rates of return over a long-term holding period."

Power of Compounding vs. Human Nature

John Maynard Keynes laid out his understanding of the quirky, contrarian nature of investing:

"It's the one sphere of life and activity where victory, security and success is always to the minority, and never to the majority. When you find everyone agreeing with you, change your mind. When I can persuade the board of my insurance company to buy a share, that, I am learning from experience, is the right moment for selling it."

As we write this letter today, the world is full of fear. Investor sentiment is extremely bearish fueled by the endless macroeconomic worries of rapidly rising inflation, increasing interest rates, the "looming recession", the war, etc. This is in contrast to just 12 months ago, when the world was full of greed and speculative gambling behavior. Just a year ago, everyone was desperately trying to get rid of cash. That was the number one enemy and it was burning a hole in everyone's pockets. The conventional wisdom was that inflation was going to destroy your cash and you have to desperately deploy your cash into any other asset (stocks, real estate, crypto) no matter what the asking price was. "Just get rid of it!" Now that the irrational, "bubble-like" valuations have come down significantly for almost all asset classes, having cash on the sidelines to take advantage of the newly created opportunities doesn't seem so bad. Now, conventional wisdom is to sell your rapidly declining stocks and go to cash because that is the "prudent" thing to do in order to protect yourself and your net worth. Well, the conventional wisdom is long on convention and short on wisdom.

Past couple of years have given us a perfect example of why more investors do not reap the benefits of compounding. The reason has surprisingly little to do with recessions, depressions, wars, financial crises, political crises, rising interest rates, inflation, stagflation, a global pandemic, or most adverse macroeconomic events. It is not adverse macro events that derail compounding, it is investors' reactions to them.

Majority of investors spend a lot of their time and energy on what we believe to be counterproductive behavior: trying to time the market (trying to sell before the next recession, trying to buy just before the next bull market), "repositioning" portfolios based on what is supposed to do better in the new paradigm (e.g. sell tech and buy energy and commodities), dumping stocks during a downturn, which deprives oneself of the means to eventually recover. This is precisely why compounding over the long term is so challenging and rare: it demands rational, grounded behavior that runs counter to human nature.

Well, this is not our game to play! We believe that long-term wealth creation is about investing in great businesses with great people and compounding capital over the long term. So, despite wars, pandemics, recessions, inflations, etc..., it's those investors that just continue to buy and own great businesses that generate excellent returns. We believe the proven secret to successful investing is simple: stay invested in great businesses and do not get too excited or fearful about the market gyrations that happen every day, and just keep with it.

"To make money in stocks you must have the vision to see them, the courage to buy them, and the patience to hold them.

Patience is the rarest of the three." - Thomas Phelps

We have observed that all returns in life, whether its investing and wealth, health, relationships, or knowledge, come from **compound interest**. Thus, we believe in playing the long-term game with long-term people - this is where the Rowan Street train is going. We truly appreciate all of you that are onboard, that trust us and believe in our vision, and we hope that this ride will create plenty of wealth and satisfaction for all our partners!

Office in New York City

On a separate note, I have recently relocated to New York City. Joe is still based in Bellevue, WA. We have not opened an office here yet, but something we are considering down the line. Please feel free to reach out if you are visiting NYC this summer. Would be happy to grab a coffee or a lunch.

Best regards,

Alex and Joe

Original Post

Move beyond stocks with our top ETF picks

The battered stock market coupled with rising rates and inflation are all pointing to the same conclusion: It's time to diversify your portfolio into ETFs.

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Rowan Street Capital, LLC is a private investment fund focused on long-term ownership of a few “extraordinary” businesses. We are neither “value” nor “growth” investors. We are compounding investors! Our investment process involves in-depth “homegrown” fundamental research and a proprietary valuation method

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