



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust



Disclaimer

Ultimately, these always boil down to the following statement:

if you choose to believe any of this, then you are on your own.

Yep, we don't like it one bit either. That said, it makes little sense for us to do anything but disclaim liability for errors, omissions and offer no warranties. Please, check everything we write, let us know when we are wrong and forgive our errors.

We do promise you this: we are human, we make mistakes, but our mistakes are honest ones. Although we do not intend to mislead, we also cannot guarantee the information in the various communication and papers we write, or that some of our ideas may be interpreted in ways we do not intend. As investors we are trying to do as good a job as we can and we write all my material in good faith to inform and educate our co-investors on our actions and thinking, all in the context of the Aligned Capital Partnership Investment Trust.

We hope that our various material, this paper included, will always be read in the same spirit in which they are written.



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

About Aligned Capital Partnership

Aligned Capital Partnership is the trustee and investment manager of the Aligned Capital Partnership Investment Trust (the **Partnership Trust**). There are no external investors in the investment manager of the Partnership Trust, so what we are doing is exercising our independent judgement about what is going to deliver the best investment returns over the long-term for the Partnership Trust.

Aligned Capital Partnership is neither a value nor a growth investor. Aligned Capital Partnership is an investor that seeks to operate with a microscope for details and a telescope for the future. Aligned Capital Partnership tilts to the long-term and that is the way the Partnership Trust is organised.

We always reserve the right to use our own considered judgement.

The entire worth of my family is invested in the Partnership Trust. We make no investments outside of the Trust. Aligned Capital Partnership has and only will have one strategy. The sole focus is on investing well for the Partnership Trust. Not on the gathering of assets.

Investors in the Partnership Trust are our fellow principals. Our view is that if we focus only on investing our co-investor's money and that of our own family's well, things will take the natural course.

The investment objective is to invest in businesses, on behalf of the Partnership Trust, that can be bought at a sizeable discount to what we believe they will be worth in the future, with a reasonable margin of safety.

We believe that our investment edge is that we can make sensible unbiased decisions that we can stick with and hold over a long-term horizon. We are not pressured by time and our natural bias is to take no action.

We believe consistently excellent performance can only be achieved through superior knowledge of companies and their securities, not through attempts at predicting what is in store for the economy, interest rates or the securities markets. Therefore, our investment process is entirely bottom-up. We do our own research on the companies and investments that we are considering for the Partnership Trust. Every day, our only considerations are "*will this investment enhance the portfolio? Will this one detract from it?*" There are no other questions.

It is our view that everyone has a different perspective, different objectives and different approaches. Ours is that of an investor. To us that means that by owning shares in a company, we have a fractional ownership of that company. As an investor, we make buy and sell decisions on the basis of the current price of a company compared with our perceived value of that company.

In our experience, the time to buy is when we think we know something others don't know, don't care about or prefer to ignore - when we look at something differently to what others do.

We believe that over the long run the share price of a company tends to reflect the fundamental developments involving the underlying business. This provides us with the opportunity to profit in at least one of the following three possible ways

1. from free cash flow generated by the underlying business, that can be used to buy back shares or distributed as dividends, which eventually will be reflected in a higher share price;
2. from an increase in the multiple that market participants are willing to pay for the underlying business as reflected in a higher share price; or
3. by a narrowing of the gap between share price and underlying business value.



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

A note to existing and prospective investors in the Partnership Trust

As alerted to when we sent out our semi-annual letter covering calendar year 2023, the cumulative returns, generated by an investment in the Partnership Trust since inception, were somewhat significantly greater than those an investment over the same period in the ASX200, the S&P 500, and the MSCI World would have generated.

While we observe that some money managers feature frequently in a range of media outlets and formats in what appears to be an attempt to raise their profile, frequently on the back of favourable returns generated, that is not an approach we make a practise of. The Little Book on Becoming a Money Manager Rock-Star is not one we have studied.

Nevertheless, we are fielding increasing inbound interest from both prospective investors wanting to invest in the Partnership Trust as well as existing investors looking to increase their investments.

As that is the case, we wanted to share with you how we think about and thus respond to some of the things most frequently discussed in conversations with prospective investors, and what our thoughts (criteria) are for accepting new investors in the Partnership Trust.

In addition to us undertaking no marketing of the Partnership Trust, probably the biggest reason for our obscurity stems from our fanaticism about accepting the “right” money, i.e. accepting investors in the Partnership Trust that we believe are right. Maintaining a culture that is conducive to rational thinking and investment success has been the top priority since inception. We have turned down significant sums of money on several occasions because of this stubborn commitment.

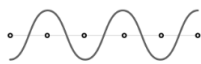
As we have stated frequently in our letters, we get far more satisfaction from producing good returns than from the size of our pay check. In fact, there are no pay checks involved in managing the Partnership Trust and we like it that way. Only if we do produce good sustainable returns will we earn a fee, and any such fee earned is re-invested in full in the Partnership Trust. Eating our own cooking is religion for us, and investors in the Partnership Trust won’t ever find us nibbling away at someone else’s cooking. We rather like our own.

Many prospective investors require monthly transparency into the portfolio and are overly focused on short-term results. Accepting money from investors with such requirements, would to us classify as “hot” money, and would endanger the culture and our ability to invest well¹.

We consider it a critical job to cultivate and maintain a culture that minimizes emotional noise and short-term performance pressures. We believe patience and discipline are critically important to investment success. Especially over the time periods we work towards. Taking emotion out of the equation, or at least minimizing it as much as possible, is vitally important and difficult to do if we have investors peering over our shoulders in real time, questioning ideas. It would be like someone telling me what’s wrong with my golf game in the middle of my backswing - while God knows I need all the help with golf that I can get, it’s the last thing I need when I am trying to concentrate and execute a shot.

Focusing on the experiences of actual people, we can’t help but notice something interesting about those who stick with an investment for a long time, through the ups and downs: they tend to have had a special connection with that investment. To them, it is not merely an instrument of financial

¹ In any event, *all* investments in the Partnership Trust are available at all times for investors to view through their individual log-in to the investor-only part of our website.



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

profit but something more, and this *something more* is woefully rare in the investment world as it stands. Our dream is that we become *something more* to the investors in the Partnership Trust.

We believe that the principle of special connection still applies, in our own way. As we have said before, and it is something we are proud of, there is a tribal-like affinity for long-termism and pragmatism that runs through our investor base. Most of us think of our investment in the Partnership Trust as one for the grandchildren of our grandchildren's grandchildren.

We know that what we describe here likely places us in a category of investing misfits, and happily so if that is the case. We happen to think these non-financial ties are of irreplaceable value. As the Partnership Trust takes in new investors in the future, they will think alike.

Some of the prospective investors with whom we have spoken have expressed admiration for our results. Yet for them to invest we would need to not only continue to find undervalued companies, in more sectors, driven by a range of themes, styles, and factors and we would need to find more of them; as well as find ideas across the globe in both large and obscure markets. Such comments are flattering, yet we see nothing but wild-eyed hubris attempting to outsmart people, more often, in more ways, and in more markets, as opposed to sticking with what has produced fine results in the first place.

Our observation is that clearly the proliferation of investment vehicles whose investment managers' interests are at odds with those of the ultimate owners of capital, i.e. the investors in those investment vehicles, has resulted in misallocation of capital.

When we speak to prospective investors, we discuss this inherent conflict with them and suggest that we think there is a more sensible approach to investing. That is one of the reasons why the Partnership Trust bypasses the agents and only speaks directly to the owners of capital.

While we are gaining traction in our approach, we are not optimistic about change on a large scale across the industry as there are multiple factors at play. Bypassing the agents is a laborious process that is difficult for a small shop like ours.

The fees throughout the financial system are in my opinion crazy and make no sense when thinking about the industry as a whole.

A lot of financial intermediaries and funds operate using a form of the "Veblen" principle² - where status is attached to the high cost and exclusivity of the product. The financial middlemen satisfy the investors' emotional needs more than the financial needs. The comfort of crowds is strongly at play throughout the system.

At the end of the day, we think many money managers are giving investors what they want - peace of mind and possibly smoother returns, albeit at the expense of long-term results.

Short-term thinking seems to be alive and well in the investment industry despite overwhelming evidence that a longer-term perspective yields better results. It is our belief that good ol' career risk may be the culprit: Non-activity in the face of short-term underperformance is simply not tolerated, even though realistic assumptions (you can't outsmart other smart people all the time) and basic math (lower frictional costs) confirm its worth. Most money managers' capital would not stick

² Named after American economist Thorstein Veblen who developed the concept where consumers purchase the higher-priced goods whereas similar low-priced (but not identical) substitutes are available. It is caused either by the belief that higher price means higher quality, or by the desire for conspicuous consumption (to be seen as buying an expensive, prestige item).



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

around long enough so they simply comply with more standard methods of operation in the spirit of keeping their jobs.

Incentives are one of the most powerful forces driving behaviour, so it is little surprise investment managers have adjusted to the prevailing industry incentives.

While we are strong believers in the power of incentives, we are not sure we have a silver bullet on how to solve the problem. We think the key is that investors need to think and act like owners, rather than short-term renters, and to judge performance over longer time frames.

American investment manager, Mark Sellers, gave a speech at Harvard several years ago. He basically said good investors have the right temperament by age 15, and there is not much one can do to improve later in life. So, we don't think arguing the merits of one's philosophy is going to gain a lot of traction - it seems people either get it or they don't.

If investors could somehow get weaned off frequent reporting and accept annual reporting (which is arguably still too often), that may help, but again, it is a hard challenge as the issue is to be found in the human nature at large.

This very issue gets to the heart of why we are fanatical about partnering only with compatible investors - those who "get it".

The sophisticated family offices, institutional investors (and others) often ask, "What's your edge?" We firmly believe it is our investor base - they act and think like owners rather than traders, which enables us to wait for and invest in exceptional opportunities. Such an investor base really adds value when you go through periods of distress and underperformance; precisely the time when you need confidence and stability is apt to be the time when investors are rushing for the exits and questioning the approach.

Part of the genius in the structure of the Buffett partnership (which has largely been maintained at Berkshire), is the culture and environment Buffett created and insisted upon; Buffett wouldn't disclose positions and reported just once a year — he created an environment where nobody was questioning how or when he swung the investment bat.

Our investment philosophy is really quite simple. We need to understand the business like an owner. The company in which we are considering an investment needs to have staying power; we want to be confident about the general nature of the business and industry landscape on a longer term basis. We are big on track records, and generally stay away from unproven companies with short operating histories. We also believe a heavy dose of humility and intellectual honesty is important when looking at potential ideas. There is a strong undercurrent constantly percolating to buy something - it's fun, exciting and feels like that's what we are here to do. This makes it easy to trick ourselves into thinking we understand something well enough when we don't, especially if we were participating in the investment derby of producing quarterly and yearly returns!

When looking at ideas, we have a Richard Feynman quote 'tattooed in the back of our brains': "Don't fool yourself, and remember you are the easiest person to fool."

Ultimately, what tends to cover all the bases is the mentality of buying the business outright and retaining management to operate it. Critical to implementing this approach is, again, having a compatible investor base. An owner's mentality forces us to think hard about the important variables and makes us think long term, as opposed to in quarterly increments. In fact, we think very little about quarterly earnings and more about the barriers to entry, competitive landscape/threats,



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

the ongoing capital needs, reinvestment opportunities, management's demonstration of astute capital allocation, and overall economics, and most importantly, the durability of the business.

Over the years we have come to better appreciate the importance of management, so we look hard at the people running the business as well. And, obviously, the price we pay needs to make sense.

The criteria bar is set high; we really try to avoid mediocre situations where restlessness causes you to relax investment standards in one area or another.

For the most, we prefer cockroach-like businesses — very hardy and almost impossible to kill!

In a generic form, we think there are many instances where a company hits a speed bump and reports ugly “numbers,” yet the long-term earnings power and franchise value remain intact. Oftentimes a key cog of value is in a form that is difficult to measure, and hence might be missed by sell-side analysts - brands, mindshare/loyal customers, exclusive distribution rights, locations, management, etc. Sometimes it is the location of assets that can be hugely valuable.

Increasingly our appetite is paltry for risky investments, almost regardless of potential reward. Theoretically this stance is illogical as ‘pot odds’ can dictate taking a ‘flyer’ — where the potential payoff compensates for the chance of loss — however we are learning that these situations are difficult to handicap, and can entice skews of probabilities and payoffs.

It can be difficult to appreciate how much simply avoiding the standard ways of failing dramatically increases the odds of success.

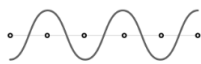
In fact, this is an interesting phenomenon: Many investors (ourselves included, at times) systematically overestimate the probability and magnitude of favorable outcomes. We recall the countless times we have read investment write-ups that peg the expected return at 50-100%, yet virtually no investor manages to achieve even 20+% performance over any meaningful period of time.

We believe that any time we are paying a price today that is dependent on heroics tomorrow - fantastic growth far into the future, favorable macro environment, R&D breakthroughs, patent approval, synergies/restructurings, dramatic margin improvements, large payoff from capex, hockey-stick like trajectory change in commodity prices etc. – we run the risk of inviting pesky over-optimism (psychologists have shown overconfidence tends to infect most of us), which can result in skewed probabilities and payoffs.

Ideally, we want to see a return today and not base our investment hypothesis on optimistic projections about the future. Many earlystage companies with short track records fall into the “too risky” category for us. Investments based on projections that are disconnected from any historical record make us leery. Investments dependent upon a continued frothy macro environment are in our opinion prone to over-optimism as well.

Many times we think it can be a situation the business is just not understood well enough and the bullish thesis is the nudge that sedates the lingering risks that aren't fully grasped.

We think it is important to keep the litany of subconscious biases in mind when investing. Charlie Munger spoke about using a two-track analysis when looking at ideas. We think that is an extremely valuable concept to implement when looking at investment opportunities. Understanding the nature and facts governing the business/idea and, equally important, understanding the subconscious biases driving our decision making – we need to understand the business, but we also need to understand ourselves!



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

We are slowly getting our heads around the humbling acceptance of understanding that winning without luck requires doing ordinary things for an extraordinary amount of time.

The way we generate investment ideas is mainly by reading a lot. We don't have a scientific model to generate ideas. We use some, but we are weary of most, screens. Mostly, we tend to use just the one screen which we believe captures the majority of what we are not looking for. When we have gotten rid of what we don't want then we start alphabetically³. We have built and continue to refine a list of companies that we think we understand well enough and would like to own at the right price.

Our job now is to try to reduce the number of companies on that list and to determine what opportunities from it we believe exist, considering our opportunity cost of capital and the investments that are currently in the portfolio.

We tend to stay within this small circle of companies. We think it is likely that in decades from now we will have owned the same companies multiple times. At that point we will probably (hopefully) be questioning why we were trading in and out of it in the first place.

It's rare for us to buy a company we haven't researched and followed for a while. We like to stick to what we know. That's the beauty of the public markets: We know that if we can be patient, there's a good chance the volatility of the marketplace will give us the chance to own companies on our list at a price we are content with. The average share price fluctuates by roughly 80% annually (when comparing 52-week high to 52-week low), or ~40% for the largest companies. Certainly, the underlying value of a business is highly unlikely to fluctuate that much on an annual basis, so the public markets are a fantastic arena for us to buy businesses, provided we can sit still without growing tired of sitting still.

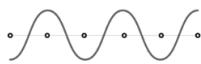
We often talk about and have written about that our old-fashioned style embraces humble skepticism and is wary of most modern risk management tools and ideas.

There is no substitute for pragmatic and critical thinking. It is ingrained in us to think about the downside before any potential upside. We try and stick with companies we understand, where we have a high degree of confidence in the staying power of the company. We spend considerable effort thinking critically about competitive threats. We stress long-term staying power and management teams with proven track records that are focused on building long-term value. Then we "stress test" the investment hypothesis against difficult economic environments. As we said earlier, we try and guard against investing in businesses reliant on some type of macro tailwind.

If we have the above, combined with the freedom to take the long view, managing the Partnership Trust portfolio is based more on intellectual honesty and common sense rather than any sophisticated "tools," "models," or "formulas." If the financial crisis taught nothing else, it showed how elegant financial models that calculate risk to decimal point precision act like a sedative towards critical thinking and even common sense - "risk models" were like the bell that told the brain it was time for recess!

We also think risk management by groups can have similar effects. Being diligent, humble, and thinking independently are in our opinion key ingredients to solid risk management. It is with in mind that we often refer to our risk management framework as "common sense, vigorously applied."

³ | admit that companies and industries that are out of favour tend still to attract my interest, if nothing else just to try to understand why they are out of favour.



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

Lack of patience, discipline, and intellectual honesty are the main factors that, in my opinion, will keep investors from reaching their goals.

Many investors are their own worst enemies - buying and selling too often, ignoring the boundaries of their mental horsepower. We think that if investors adopted an ethos of not fooling themselves and focused on reducing unforced errors as opposed to hitting the next home run, returns would improve dramatically. Most money managers don't have the leeway to patiently wait for the exceptional opportunity.

The reality is that winning without luck requires doing ordinary things for an extraordinary amount of time.

Ask any money manager what they are seeking to achieve, and the response will be some variation of "buy shares that will go up in price". However, maybe a better approach is to use inversion. That is, the better strategy is seeking to avoid risks that have a high probability of leading to permanent loss of capital and lower returns, than chasing high, and often risky, returns. Rejecting potential bad investments is the main activity for us.

We think there is a lot of truth to the saying about money managers: some of us are bold, and some of us are old. However, there are few, both bold and old.

The bold investor often ends up underperforming or, worse, going broke.

Our mandate for the Partnership Trust allows us to make the best investment decisions possible, not the least bad ones. We operate with a charter that enables us to invest across the capital structure in Australia or abroad, in public and private markets.

This breadth is a foundational element for the Partnership Trust. If we were to try to fit ourselves into a box, we would be constrained to make the best possible decision as defined by the surrounding walls. Sometimes the menu of options available within that box may not offer asymmetric let alone compelling risk/reward. At worst, there will be times when the odds are stacked against due to prevailing valuations. Instead, we embrace a strategy that allows us to search across industries, asset types, geographies, and the capital stack for opportunities where we believe the odds are in our favour before we place our bet. If we can't find such a game, we wait until the cards are more to our liking.

So far, we have gotten more right than wrong in making our capital allocation decisions.

Despite that, we still find ourselves learning and don't plan for that to change. Of the many lessons we have learned, these four stand out to me. We encourage anyone who has money to invest, whether in the Partnership Trust or elsewhere, to consider these:

1. **Determine what strategy works best for you and stick with it.** Whether you yourself invest your capital or you allocate it to others, you must execute a replicable process. You should find a style that synchs with your personality so that when tested during stress, you are not getting pushback from the person in the mirror. There isn't one right way, but there's probably one way for you.

Knowing what is in and out of bounds for you will help keep you focused and help you steer clear of the FOMO that might otherwise drive you to participate in the latest and greatest, but ultimately fleeting.



ALIGNED CAPITAL PARTNERSHIP

A note to existing and prospective investors in the Partnership Trust

2. **Do nothing most of the time because there is nothing to do most of the time!** Great opportunities only happen some of the time. Doing more can cost you more, particularly if you are a taxable investor. If you bought a great business well and its price quintupled, you should think twice before selling. After you sell and pay your taxes, you might find yourself with 20-30% less to reinvest. The same goes for an investment in the Partnership Trust. Remember the wise words of Charlie Munger, “The first rule of compounding: Never interrupt it unnecessarily.”
3. **Don’t run with the crowd.** It’s better to operate with a variant view. Most people feel insecure investing in what may not be currently working, especially if it means running in the opposite direction of the herd. But if you have done your due diligence, then that is what you should do. If you actively seek diverse well-reasoned views that challenge your thinking, you will avoid the confirmation bias of living in an echo chamber. This will allow you to buy into weakness and sell into strength. Or, as we said, do nothing. Do it yourself or have a proven well aligned manager whose sensibilities dovetail with yours do it for you. If you’re allocating your money to someone else for them to invest it for you then avoid the closet indexer and chose someone who is comfortable when looking wrong over the short or intermediate term to be right over a more extended period.
4. And lastly – **look at each new day with fresh eyes, learning and expanding your circle of competence.** Develop new tools and use old ones differently so you can apply them in different environments to take advantage of the opportunities and avoid the pitfalls unique to that time.

I know that I, and we at Aligned Capital Partnership, will learn from different mistakes and lessons in the coming decades. You may too. Despite that, I feel certain that if you remember these lessons, then you will have a head start from where I was when I began.

You don’t need to make the same mistakes we have made. Before the invention of safety razors, it was best to learn to shave using someone else’s face. We offer you our experience and nicked cheeks so that you may avoid some of our mistakes.

Hopefully, this helps you make more money over time while sleeping better at night. Both continue to be important to us.

Erling Sorensen

Erling Sorensen

Aligned Capital Partnership Pty Ltd

13th of May 2024