KP7

July 6, 2023
Letter #10

Dear Investors:

KP7 was up 8.7% after all fees and expenses in the second quarter of 2023, which exactly equaled the return of the S&P 500. For the year, KP7 is up 18.7% after fees and expenses versus a return of 16.9% for the S&P 500.

A year ago, we described the early-stage transformation of the Brazilian financial services industry. We own three of the digital-first disruptors and all three were material contributors to our performance in the second quarter. XP (+88% in the quarter) is an online Brazilian broker similar to Charles Schwab in the United States. StoneCo (+33%) provides both hardware and software to Brazilian merchants to allow them to accept credit cards. Nu Holdings (+66% in the quarter) provides online bank accounts and other financial services to individuals not just in Brazil, but in Mexico and Colombia as well.

The disruptors are low-cost, fast, and nimble. The incumbent banks are high-cost, slow, and bureaucratic. We think the disruption has years to play out.

Palantir (+82%) was another winner in the quarter. CEO Alex Karp is one of our favorites. Palantir sells software that integrates data from disparate sources so people can make better decisions. The software has both military and commercial applications. We scooped up shares and made Palantir one of our largest positions as its stock slid to all-time lows late last year.

• • • • •

While our conviction in Palantir and the Brazilian disruptors is still quite high, we did trim the size of each late in the second quarter based on valuation and portfolio considerations. We used some of the proceeds to add materially to our positions in dLocal and Impinj.

dLocal provides merchants with software that facilitates cross-border e-commerce. dLocal figures out all the red tape associated with selling products and services into certain emerging markets, imbeds that expertise into software, and sells the software to merchants wanting to sell products and services into those countries. By focusing on specific complex countries and selling its expertise to multiple merchants, dLocal provides a higher quality product at a much lower cost than its much larger customers could do on their own. Companies like Microsoft, Meta, Amazon, NetFlix, Uber, Tencent, Spotify, Salesforce, and many others have signed up for its service, which we believe validates dLocal's value proposition.

In November 2022, dLocal experienced the unforgettable smack of a broadly-circulated short-sellers report. Its stock was down 60% in one day. We unfortunately had not yet completed our work on the company when the report came out, so we didn't buy the stock at scale at the time. We have since done an extensive deep dive on the company. We like what we see.

We take short reports like this seriously. We first try to figure out whether they have legitimate critiques of the company. We then try to use the information to our advantage.

Short sellers as a rule are highly critical people and they obviously focus on the negatives. When they do have legitimate critiques, they sometimes highlight bona fide hidden risks that we hadn't considered. We are always on the lookout for hidden risks that have yet to become obvious. That is one way we protect capital. We love protecting capital.

Sometimes short reports do not have legitimate critiques of the company. In those cases we capitalize on the short report in a more direct way: we load up on a high-quality cheap stock. That is what we did with dLocal.

We analyzed dLocal's business model. We assessed its value proposition. We spoke with both its management team and members of its board. In June, we backed up the truck and made it one of our largest positions.

We know enough about the people that make a living shorting stock to double check their facts and theories. Sometimes they are legit. Sometimes they aren't. Short reports can be insightful. They can also be sloppy and biased. At times, short sellers even intentionally spread false narratives about a company in order to incite price action (i.e., selling) that benefits their portfolio. We could be wrong about dLocal, but we have done enough work to think otherwise. Time will be the ultimate arbiter.

• • • • •

Impinj is a small company with a big opportunity. It makes tiny silicon chips, which are smaller than a grain of sand. Manufacturers and logistics companies incorporate the chip into products in order to track the location and identity of the product. Impinj chips essentially take the place of bar codes and eliminate the need for a physical scan. By connecting wirelessly to the internet, these tiny silicon chips have tremendous data-storing capabilities.

With Impinj chips incorporated in products, retailers can inventory an entire store by simply scanning the aisles with an electronic reader. Self-checkout becomes easier. Tracking packages for logistics companies is fast and simple. The cost of a chip is about a penny.

The antennae and packaging add another 3 to 4 cents. For less than five cents per item, manufacturers, logistics companies, and retailers can electronically tag products to track and identify them throughout the value chain. The value proposition is big. Unit economics for Impinj are great. The market is potentially enormous.

• • • • •

We have a unique product at KP7. We offer just one portfolio, a portfolio that includes our best investment ideas and only our best investment ideas. We construct our portfolio with two goals in mind: 1) to maximize performance and 2) to minimize the probability of permanent capital loss at the portfolio level. We think the two goals go hand-in-hand. They are consistent and complementary. We actively strip away all obstacles that could prevent us from achieving those goals.

We work every day to gain and keep your trust. Please let us know what we can improve. All the best to you and your families.

Sincerely,