TOURBILLON

INVESTMENT MANAGEMENT

Partnership Principles

Although our form is corporate, the relationship we wish to build with our clients is a partnership. We believe this requires shared values and expectations as well as honest and transparent communication. The purpose of this document is to help you understand our business, our philosophy, our goals, and our limitations. Though certain elements of our business will evolve and adapt, these bedrock principles will not.

Business owners

We view the fund as a holding company investing in a small number of high quality, durable businesses globally. To us, there is no meaningful distinction between owning common stock relative to outright ownership of a business. Stock prices are volatile, with 50% peak to trough moves over the course of a year not unusual. Businesses, specifically their cash flows and intrinsic values, are far less volatile. Our actions are determined largely by the *fundamentals* of the businesses we invest in.

Aligned

We see our clients as owner-partners, like we are. This requires a clear alignment of objectives which we look to achieve in two distinct ways: communication and incentives. We will communicate through our semi-annual reports supplemented with frequent memoranda available at our website (www.tourbillonpartners.co.uk). You can also reach out to us directly. Our incentives are also aligned. All our directors have significant investments in the partnership alongside you, and on equal terms. Our fee structure also emphasises performance over fixed incentives. We eat our own cooking.

Focused

Our mandate is broad, but the characteristics we seek in an investment are rare. Furthermore, we will only invest within our circle of competence. As we will not compromise on either, our actions are likely to be infrequent, but decisive. As client-partners, you should be aware that we do not aim to be all things to all people and are likely to 'miss out' on many investments which do not clear our self-defined hurdles for quality and durability. We will have between 15 and 25 investments with a high degree of concentration amongst the largest holdings.

Real return

We look to the cash generation potential of a business as an indicator of its value. Our target, one which we may exceed or fall short of, is to deliver annualised returns of 15% over rolling five-year periods. Although we expect this to compare favourably relative to broad market averages, our focus is on absolute, real returns. We expect significant volatility over shorter periods of time. We believe enduring such periods is the price to pay for superior long-term results.

We will also not use derivatives, short stocks, or employ leverage; and are generally wary of leverage taken on by the companies we invest in too. This conservative approach may lead to lower rates of return at certain points in the economic cycle but, we believe, will deliver superior risk-adjusted returns, and prove a more pleasant experience. We will not chase uncertain but high returns in investments we do not understand. Our priority is capital preservation before capital appreciation.

Narrow but deep — *fishing where the fish are*

The distribution of equity market returns over longer periods is such that a small fraction of companies, just over 1%, generated *all* the shareholder wealth in global stock markets. Although the volatility inherent to equity markets encourages frequent activity and a belief one can generate superior returns through trading, we believe the best use of our time and effort is to focus on the 'fat tail' of investments which generate the bulk of returns over the long-term.

There are over 40,000 listed companies globally and, due to our mandate and size, we can invest in a large portion of these. However, it would be impossible for us to keep abreast of all these businesses. Therefore, it is imperative that we narrow the universe. We do not narrow by geography or sector (as is conventional), but by the characteristics which will lead us to these exceptional companies. This allows us to be flexible *and* selective.

Like a *tourbillon* in a mechanical watch that counters the effect of gravity, the businesses we seek have a few distinctive qualities that enable them to defy the pull of competition towards mediocrity:

- Durability. Predictable business models which are difficult to replicate.
- Quality. High returns on capital enabling growth and shareholder returns.
- Stewardship. Management with both skill and integrity.

Identifying quality businesses — *the mental models that guide us*

Although history can, and does, guide our thinking on the nature of durability and returns, we believe it is more valuable to have a first-principles approach which looks beyond historical quantitative measures. We focus on three mental models which we believe reflect deep truths that have endured over decades: *fulcrum assets*, s*ymbiotic loops,* and *outlier management*.

- *Fulcrum Assets.* Literally, the term means 'the main pivot needed for something to work.' In practice, we use the term to describe the type of business models which provide a critical product or service within the value chain in which they operate. These assets have both demand- and supply-side dynamics. In the eyes of customers, the lack of close substitutes, real or perceived, leads to valuable customer propositions. It also leads to high switching and search costs as well as customer loyalty. They may also be companies which have scarcity value such as control of key ingredients, technologies, or infrastructure. Our belief is that a genuinely idiosyncratic, difficult-to-replicate asset will retain its relevance and value over time.

- *Symbiotic Loops.* Relentless competition is a defining feature of free markets. For a business to generate durable economic profit, it must create value for *all* its stakeholders: customers, suppliers, employees and regulators included. Companies which demonstrate these qualities often form a virtuous cycle where growth leads to exponentially improving outcomes, a *symbiotic loop*. Importantly, this does not always lead to high returns on capital at any given point in time. Management may choose to defer gratification and re-invest into their business to maximise long-term value creation. A lot of our work involves understanding the fundamental truth of a business, its unit economics and long-term competitive advantages. This allows us to look through periods of upfront investment or, conversely, steer away from companies generating unsustainable profits.

- *Outlier Management.* Stewardship is vital for any company. If a company earns, say, a 20% return on capital, the management will have been responsible for redeploying *all* the capital initially in the business within four years. The qualitative judgments around capital allocation are incredibly important yet generally under-appreciated. We emphasise the incentives and track record of the management we partner with. We also have a strong preference for owner-operators who are meaningful shareholders and care deeply about the business beyond just the financial stake. We believe this alignment of interest encourages long-term thinking and a sustainable value creation mindset. Although we look for management who share our values and philosophy before investment, we will engage on strategy and capital allocation where appropriate.

The result of the above – identifying sustainable competitive advantages through the lens of these mental models – is likely to be a portfolio which will, on average, have a high return on capital. However, we really hold ourselves to the inputs rather than the output. Over time we will communicate how your investments demonstrate the attributes we seek.

Building a margin of safety — *our value orientation*

"Common yardsticks such as dividend yield, ratio of price to earnings or to book value, and even growth rates have nothing to do with valuation except to the extent they provide clues to the amount and timing of cash flows into and from the business." –Warren Buffett

We are long-term value investors. The traditional definition of value investing is defined in purely statistical terms, typically buying an asset at a low price relative to an accounting metric like earnings, cash flow or book value. In contrast, growth investing may suggest a disregard for price.

Our approach is different. We believe that all intelligent investing involves buying a company for less than its worth as defined by the amount of cashflow it will produce over its lifetime. Our 'indefinite' time horizon also makes runway for growth an important consideration. Equally, quality is part of the equation as growth will only create shareholder value if achieved through high returns on capital. Therefore, to us, growth, value, and quality are all inextricably linked.

Stocks as part-ownership of productive businesses

Stocks are volatile. This is because markets are human constructs and hence prone to behavioural excess. However, it is inarguable that common stock is fundamentally an ownership contract laying claim to the cash flow of the issuing company after obligations to all other stakeholders have been met – including customers, suppliers, employees, governments, and debt-holders. Over time, stock prices converge with fundamental business value, or an appropriate yield on the cash flow attributable to owners.

Absolute value mentality

Over more than a century, equity markets have delivered approximately 6.5% a year above inflation. Our, admittedly lofty, objective is to achieve 15% annualised returns, effectively doubling our partners' capital in five years. This is, in turn, built on the long-term cost of money as well as what our opportunity set suggests. Both empirical study and our direct experience suggests that achieving high rates of return needs the twin engines of a quality, growing business and a reasonable valuation. In fact, the price paid for a security is perhaps the most crucial determinant of the eventual return obtainable from it.

We apply a conservative approach to valuation borne through the knowledge that the future is hard to predict with any precision. As a reference, the average life of a listed company in the United States is approximately 20 years and shrinking. There are companies which have been around much longer but trying to make precise long-term forecasts is a fool's errand with far too much room for error. Forecasts tell you something about the person making the forecast, but very little about the future.

A double-barrelled approach – an absolute value discipline applied to a small subset of quality, growing businesses – is an important foundational building block for how we will manage your capital.

Management of the *Tourbillon Investment Partnership*

Tourbillon has been created with one purpose – to compound the partnership's capital at high rates over the long-term without taking undue risk. This objective has guided our structure, which we believe is rare amongst professional investors. We will remain steadfast in our approach whilst keeping our eye on the horizon.

These are our foundational principles:

- *People.* We avoid principal-agency problems associated with large teams or committees. All investment decisions are made by two experienced portfolio managers with equal ownership of the portfolio working with mutual respect, trust, and veto.
- *Aligned*. We will have most of our personal liquid net worth invested alongside you, on the same terms.
- *Capacity.* We will restrict inflows to maintain a balance between conviction and the ability to invest in our opportunity set which will skew towards small and medium sized companies. Our current estimate of capacity is $2 billion.
- *Fees.* Our 0.5% fixed management fee, with performance fee of 20% of the outperformance over a 5% hurdle rate (with high water mark), aligns our interests with long-term returns.
- *Focus.* We have only one strategy and we have no alternative forms of compensation.
- *Clients.* We do not aim to be all things to all people. We aim to foster direct relationships with our clients who we view as owner-partners in the business. We believe that having partners who share our investment philosophy and time horizon is key to being able to invest intelligently in the manner we have described to you.
- *Structure.* We strive for simplicity and excellence in our operations. Specifics about our structure, context as well as operational counterparties are available in our most recent presentation materials.

It is an absolute pleasure and privilege to be managing the partnership on your behalf. We will work tirelessly to earn the confidence you have placed in us.

Thank you.

Ben Beneche
&
Ramesh Narayanaswamy

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