To: Highway One Fund Partners
From: Stefan Culibrk
Subject: Annual letter 2022
Date: 13 January 2023

Dear Partner,

The Highway One Fund has returned -2.7%[1] since its inception on 1 April 2022.

I have five criteria for allocating the Fund's capital. They reflect my experience, weaknesses, and strengths. First, the company needs to offer a valuable product or service. Second, I need to feel comfortable that the returns on capital will be attractive in five years and sustainable from then onwards. Third, I want the business to have the ability to reinvest profits at attractive rates of return. Fourth, the company's leadership must be trustworthy, skilled in capital allocation, and adequately incentivized. Finally, I will pull the trigger only if the business is available at a price that gives us a clear path to attractive annual returns for at least five years, with limited downside.

The criteria are not a formula. For example, Airbnb, a new addition to the portfolio, earns extraordinary returns on invested capital. Yet it is capital-light and cannot possibly reinvest all its profits. It is an excellent problem to have. In such cases, alignment of interests and capital allocation acumen are critical. Other companies have management teams that have not had the chance to demonstrate their capital allocation wisdom beyond reinvesting in the core business. Thomas Peterffy founded Interactive Brokers in 1978 and still reinvests its profits. If the runway for profitable growth is long enough, I will let the management keep at it.

Several companies satisfy the first four criteria but fail to give us a chance to earn anything close to our bogey. If I were to lower the bar of expected annual returns to 12%, I would allocate our cash in a matter of hours. You are right if you think 12% is a decent return. The problem is that lowering the bar almost guarantees lower returns. Hurdles have a magnetic force. Unpleasant surprises happen. Lowering the bar leaves no margin for error, increasing risk.

After larger finches inhabited their island, Darwin's finches developed beaks capable of eating smaller nuts, which were too difficult for the larger birds to crack. Highway One Fund will adapt, just like any organism looking to thrive. While the emphasis on each criterion may evolve, or the geography where I apply them, do not expect me to change my religion.

[1] Please see page 9 for comparison to relevant indices and a brief discussion about an appropriate yardstick for Highway One Fund. See page 10 for a detailed breakdown of contributors to performance.

The goal of the Highway One Fund is to deliver a superior long-term rate of return to the partners after fees and taxes. I will fail to achieve the goal if we keep having a significant cash allocation. However, compromising on the criteria is not the road to the promised land either.

The bar to enter our portfolio is higher than ever, and only a handful of companies pass it. Over the past year, I have tightened the criteria and intensified the research process. When you see our cash dwindling, it will not be due to my patience running out but the research process bearing fruit.

<u>New position – Airbnb, Inc.</u>

Airbnb is a marketplace connecting 4 million individuals offering rooms and whole housing units, with hundreds of millions travelling for pleasure, work, or long-term stays. Brian Chesky, Nate Blecharczyk and Joe Gebbia founded the company in 2008. The company has been nothing short of an economic miracle for the hosts, allowing them to earn $200 billion since Airbnb's founding.

In a typical transaction, the hosts keep 97% of what they charge. The rest of the fee is applied to the guest for a 13.1% all-in take rate charged by Airbnb. Pricing is favourable compared to online travel agents Booking and Expedia, which take more and charge the full fee to the host. In contrast to Airbnb's non-branded, fragmented supply of accommodation, guests can book away from online travel agents and directly with hotel websites that reward them with perks such as complimentary breakfast. Over time, I expect Airbnb to increase its take rate, reflecting its enormous contribution to the hosts' income.

Three years ago, things looked dire for Airbnb. As COVID-19 spread across Asia, the management made difficult decisions. The company dramatically shrunk the fixed cost structure, eliminating unprofitable projects and a quarter of the staff. Performance marketing was put on hold.

Today, instead of buying traffic for billions of dollars, almost all visits to Airbnb happen organically – because someone wanted to find accommodation on Airbnb. Credit is due to the creative public relations and brand marketing departments. Awakening to cost control during COVID-19 set the business on a path towards becoming the cash-gushing machine it is today. The company has generated $3.3 billion in free cash flow in the past twelve months and holds $10 billion in cash.

In the twelve months leading up to September 2022, Airbnb facilitated 378 million nightly stays, less than 5% of global nights booked. Over the coming years, Airbnb will enable more visits, the take rate will expand, and operating leverage will translate higher revenue into significant free cash flow growth.

Airbnb's management has not invested the cash raised in the public offering or the recent profits. Yet, before going public, the management team made important capital allocation choices. They designed a capital-light business with significant negative working capital and gave up only a portion of the shares in exchange for funds to accelerate growth. If the recently announced buyback plan is a clue, Brian Chesky's capital allocation thoughtfulness has extended into its life as a public company.

New position – Ryanair Holdings Plc

Ryanair is Europe's lowest-fare, lowest-cost, and highest-margin airline. It is also the largest by the number of passengers flown. Customers want low fares and Ryanair delivers them. Like any other commodity industry, the lowest-cost operator has a good chance of winning European short-haul.

The force behind Ryanair's low-cost culture is Mike O'Leary. O'Leary joined near-bankrupt Ryanair in 1988. He brought Southwest's low-cost model to Europe and perfected a no-frills experience. The first step was to unbundle airfares from ancillary services such as luggage and beverage. Flying to second-tier airports (Paris Beauvais or Stockholm Skavsta, anyone?) improved aircraft utilization due to quick turnaround times. As Ryanair gained scale, it became a critical customer for the airports and further reduced unit costs. Ryanair would deliver the passengers and the airport had to make its living from duty free shopping. Ryanair's profitability and scale allowed it to buy aircraft in large orders directly from Boeing and own them after the delivery, improving the level and predictability of its unit costs.

Profitable, capital-intensive businesses can be replicated in their infancy, bringing down the returns on capital for the incumbent. Wizz Air happened because, in 2004, Ryanair wasn't large enough to compete them away. At the time, Ryanair was chasing opportunities on multiple fronts. When O'Leary subsequently tried to take over Wizz Air, he could not agree on the price with Bill Franke, chairman of Wizz Air. Today, an airline starting with one or two routes would face an immediate flood of capacity from Ryanair. A contained price war would not hurt Ryanair's overall profitability while devastating the competition. There are few industries where a new entrant faces as dire chances as in the European short-haul airline industry.

Over the short term, the industry is volatile. Unit costs swing with oil prices, currency, and interest rates. Air traffic control strikes, and airport understaffing disrupt the customer experience. Consumer sentiment dictates ticket sales.

Look further and the clouds disappear. A strong balance sheet, a lean operating model, and low prices are a recipe for success. Ryanair averaged an operating profit of 10 euro/passenger during the 2010s. It has been keeping its prices low to expand the market and take share until, ultimately, the industry consolidates and Ryanair, as its price setter, can raise prices. I expect them to make at least as much when the delivery of their current aircraft order expands capacity by 60% and brings the European short-haul market closer to a consolidated state. By 2026, Ryanair should be making more than two billion euro per year.

Profitability could weaken in the short to medium term. Inflation has hurt purchasing power, and discretionary spending will weaken as soon as consumers spend excess savings accumulated during the lockdowns. Nevertheless, I expect Ryanair to remain profitable in a recession. A recession would be a long-term positive for Ryanair, as all competitors have weaker balance sheets and higher cost bases. Their capacity reduction will fuel the continuation of Ryanair's profitable expansion.

New position – Graphisoft Park SE

In 1996, Gabor Bojar was the chief executive of Graphisoft, a leading architecture software firm he co-founded in Hungary in 1982. Recruiting and retaining talent were his most important tasks. He figured his employees might want to work in an inspiring environment resembling a university campus instead of a glass tower. Finally, after two years of searching, he found an ideal plot for his ambitions, next to the Danube in the Óbuda district of Budapest.

Graphisoft moved into its new building in 1998. When Bojar sold Graphisoft to German software conglomerate Nemetschek in 2006, he decided to separate Graphisoft's real estate portfolio into a newly formed listed entity called Graphisoft Park. What started as 4,500 square meters for own use in 1998 serendipitously expanded into 73,000 square meters of office space for the largest technology companies in Budapest. Tenants today include SAP, Graphisoft, and Microsoft.

Bojar, the chairman, and Janos Kocsany, the chief executive, have continued meticulously and conservatively operating the office park since its public listing. The park expanded capacity when low-cost financing was available and the occupancy reached capacity. Although based in Hungary, it indexed rent prices in Euros and tied them to Eurozone inflation. It grew its footprint four-fold in fifteen years without issuing additional shares.

Graphisoft Park shares have declined 24% in 2022 and 40% compared to pre-COVID-19. While the rise in interest rates decreases the value of the real estate, the impact should be minor on Graphisoft Park. It has fixed rate debt at 2% interest and keeps the net debt conservative compared to revenue and free cash flow.

We were able to purchase shares in Graphisoft Park at a 15% free cash flow yield. Over the coming years, management will use the cash flows to pay dividends, add buildings, and repay debt. Bojar's 30% stake in the company worth 25 million euros aligns his interest with ours.

Hiccups could happen on the way. Microsoft has recently changed offices in Bucharest and Belgrade in favour of more modern, larger buildings. When a large tenant leaves, it can take a year or two to lease the space again. The property owner bears the cost of refurbishment and utilities while waiting for the replacement. Graphisoft Park has had one major tenant leave in its 25-year history. Significantly higher utility bills and working from home could change this. Despite the headwinds, recent transactions of Budapest office space closed at enterprise values that peg Graphisoft Park's equity at twice our entry price.

Graphisoft Park is our first investment in Eastern Europe. I am aware of the political risks that such investment carries. In addition, Bojar is a rare voice of dissent against Hungarian Prime Minister Viktor Orban. Punishment to date seems to be contained to the government's decade-long reluctance to execute the costly but contractually binding remediation of a land plot it sold to Graphisoft Park in 2008. The delay is not affecting Graphisoft Park's current revenues but is limiting the room for expansion.

Exited position – Wayfair

We bought shares of Wayfair at $69 during April and May. We sold for slightly more in August. I hypothesized that Wayfair's founder-led team was in the early innings of building a dominant company in a vast category. Unfortunately, both sides of Wayfair's marketplace are not evolving to support the hypothesis.

On the demand side, more than 100 million households have tried Wayfair. For a category that is an annual purchase, it is concerning that less than 20% of customers who tried Wayfair come back to it every year. A minority that keeps returning spends less than a fifth of the yearly budget for the home category. Consequently, Wayfair spends the same percentage on advertising today as it did in 2015. On the supply side, the business relies on an increasingly tenuous flow of goods between China and the United States.

My recent interviews with former employees signalled a weaker internal organization than I had initially anticipated. The company was beginning to be "run by consultants rather than engineers". I prefer companies whose competitors use consultants. The current cost structure does not seem to reflect investing for growth, but inefficient operations, littered with manual processes.

The above made me reduce the chances of getting to the hypothesized dominance and I promptly sold the shares.

<u>Operating review of 2022</u>

Airbnb, Inc.

Airbnb's summer release focused on pointing demand towards various supply categories, from camping to lakefront. Searching by category will allow Airbnb to insert itself closer to the idea stage of the holiday planning. If executed well, this change in design can reduce marketing costs and increase occupancy.

The winter release focused on increasing supply. Airbnb is introducing Superhosts, top-rated and most experienced hosts, as guides to the new host onboarding process. In addition to AirCover for guests, Airbnb has improved AirCover for the hosts, giving them peace of mind when they let someone into their home.

While Airbnb is in the same business as in 2019, today, it is a different company.

	2019	2022*
Bookings ($bn)	38.0	61.1
Free cash flow ($bn)	0.1	3.3
Free cash flow as a % of Bookings	0.3%	5.4%
Profit per night booked ($)	(1.5)	4.6
Net cash ($bn)	3.1	7.6

* October 2021 – September 2022

While the near-term demand will always depend on the broader economy, I expect Airbnb to retain the cost discipline and maintain its incremental margins, if not expand.

Interactive Brokers Group, Inc.

In a year of despair among its users, Interactive Brokers has increased their count by 25%. At the current pace of monthly additions, it will grow accounts by 15% in 2023.

Trading per account has markedly slowed from 57 trades per month in February 2021 to 18 in November 2022. The customer activity is begging to resemble a brokerage rather than a casino. Higher commissions per order somewhat offset the decline in activity.

The real star of 2022 was the rise in interest rates. Despite a decline in margin loans due to waning risk appetite, Interactive Brokers grew its net interest income in Q3 by 72%. As a result, its pre-tax income will likely exceed $2.1 billion, a record.

I expect more of the same from Interactive Brokers in 2023.

Ryanair Holdings Plc

Airlines across Europe had a terrific 2022. Ryanair flew 96% full during the summer, with the fewest cancellations of any airline, despite air traffic control and airport staff-induced delays. Ryanair made significant market share gains in Italy, Hungary, Poland, and Ireland.

Cost control is as firm as ever. Its per-seat, ex-fuel costs are 35% to 60% lower than Wizz Air and Easyjet, respectively. Boeing 737-8200 deliveries increased capacity 15% above the pre-COVID-19 peak.

The exception to the rare moment of prosperity in the industry is Wizz Air, Ryanair's main competitor. It had not hedged its fuel or dollar exposure before the conflict between Russia and Ukraine and suffered significant losses. In contrast to Ryanair, Wizz Air leases its aircraft. Its four-billion-euro lease liability will only increase as its large aircraft order from Airbus gets delivered. An economic downturn could leave Wizz Air desperate for cash and force it to issue additional equity.

Mike O'Leary renewed his contract. He will get rewarded if the share price hits 21 euro or the airline makes 2.2 billion euro in profit by 2028. O'Leary owns 4% of Ryanair, worth more than half a billion euro.

Liberty Broadband Corp

Charter Communications, Liberty Broadband's primary asset, has had a difficult year. T-Mobile's fixed wireless offering is taking significant share of switchers from DSL. It also fills the need for internet in remote areas where Charter might have expanded next. While Charter's strong pricing and packaging have limited subscriber churn so far, fixed wireless will remain a drag on growth until data speeds and consumption increase to a level where fixed wireless cannot compete.

On the other hand, Charter's mobile business is booming, adding more than 1.5 million customers in 2022 through its mobile virtual network operator agreement with Verizon. Customers are eager to achieve significant savings by switching to Charter.

Tom Rutledge, Charter's long-time chief executive, retired in September. Chris Winfrey, chief operating officer, has been promoted to the top post.

Graphisoft Park SE

The park has an occupancy of 98%, at an average monthly rent of 18 euro/m^2, in line with the market average for quality offices. During my visit in October, the cafeteria and the restaurant were surprisingly buzzing. Microsoft and SAP are increasingly hiring for hybrid roles but still expect employees to show up at the office two to three times per week. If they do, the companies keep an assigned seat for them. Seat occupancy at Graphisoft Park is 65% and growing.

Rents will increase by 10% next year, adjusting for 2022 inflation. Utility bills, directly paid by the tenants, have risen to c. 15 euro/m^2. A slower economy, higher rents, and an increase in remote work will probably lead to some tenant cancellations in 2023.

The company approved changing its listing currency from Hungarian forint to the euro to reflect its euro-linked revenues.

Conclusion

It was a thrill to see you in Belgrade for our first annual meeting. For those that did not make it, I hope to see you in October 2023.

Thank you for your confidence in Highway One Fund. I could not be more excited about the days ahead.

Sincerely,

Stefan Culibrk

Table 1 – Comparison to relevant indices

	Return (EUR)	S&P 500 (USD)	S&P 500 (EUR)	MSCI World TR (EUR)
Since April 1st 2022	-2.7%	-14.2%	-10.1%	-9.7%

Yardstick for the Highway One Fund

When I managed your account at Interactive Brokers, you handed me over USD, and we measured your performance in USD. We compared performance to the S&P 500 Total Return index quoted in USD that reinvests dividends. Apples to apples.

When you invested in the Highway One Fund, you invested EUR. Accordingly, we measure the value of units in the Highway One Fund in EUR. While I typically ignore currency fluctuations, the volatility of the EUR/USD exchange rate during 2022 demonstrated that a USD yardstick is inadequate for a EUR-denominated fund. Therefore, we need a EUR yardstick.

We could convert S&P 500 Total Return from USD to EUR, but I want to propose a different yardstick. We currently own no shares from the S&P 500, and I expect us to hold more international businesses over time. MSCI World Total Return, measured in EUR, strikes me as a more appropriate yardstick. Companies from the United States dominate the index, accounting for two-thirds of the weight. The remaining third are companies from developed countries such as the United Kingdom and France. We will compare the performance of the Highway One Fund to the MSCI World Total Return EUR using MSCI data.

You should, of course, compare the fund with whatever makes sense for you. The comparison will be most effective if conducted over a longer period.

While the yardstick changes, the important things remain the same. Although we are counting in EUR, we will not hedge currency exposures. And we certainly do not plan to pay attention to the index's composition and how our portfolio compares to it.

Table 2 – Contributors to returns from April to December 2022

Company	Contribution	Return (EUR)	Weight
Airbnb, Inc.	-2.7%	-25.5%	9.00%
Ryanair Holdings Plc	+0.3%	+4.8%	6.30%
Interactive Brokers Group, Inc.	+1.4%	+30.1%	6.10%
Graphisoft Park SE	-0.1%	-6.1%	1.60%
Liberty Broadband Corp	-0.4%	-29.2%	1.10%
Wayfair Inc.	+0.2%	+5.0%	/
Management fee	-0.8%		
Interest expense	-0.1%		
Fund operating costs	-0.4%		

Source: Bolder Group, Interactive Brokers
Data as of December 31, 2022

Contribution is calculated by dividing the EUR P&L from a line item in the period with the fund's average assets during the period. Interest expense comes from negative interest rates on our EUR cash balances during Q2 and Q3 of 2022. Fund operating costs include fund administration, trade execution, bank charges, regulatory and other fees.