To: Highway One Fund Partners
From: Stefan Culibrk
Subject: Semi-annual letter 2022
Date: July 14th, 2022

Dear Partner,

Highway One Fund returned -1.9% since its inception on April 1st, 2022.

	Return (EUR)	S&P 500 (USD)	S&P 500 (EUR)	MSCI World TR (EUR)
Since April 1st 2022[1]	-1.9%	-16.4%	-10.7%	-10.7%

We stopped managing your wealth via separate accounts at the end of 2021 and started the Highway One Fund. Our goal is to compound capital at the highest possible rate, and creating a fund is picking up the low-hanging fruit. Instead of paying capital gains tax every time we realize a gain, most of you will now pay when you liquidate the investment in the fund. The change in the timing will do wonders for compounding. In addition, the lucky ones among you will take advantage of Serbia's exemption from capital gains taxes for investments held for more than ten years.

While close, the move to a fund is not a free lunch. The fund carries administrative and regulatory expenses currently shared between the partners. I will pick up the tab in the years that Highway One Fund starts with more than EUR 20m.

Since my last letter, the war in Ukraine and inflationary pressures have dominated the news. Geopolitics are easy to interpret in hindsight but difficult to ascertain in the heat of the moment. Economic flows are a more reliable barometer. Western businesses that invested in Russia over decades abandoned operations overnight. Although the events played out quickly, the consequences will last. The ripple effects of the change in the status quo can be powerful and unexpected.

Inflation is as problematic in the developed world, which stimulated economies during the pandemic, as it is in poorer countries that spend more on food and energy. The good news is that central banks have the tools to reduce inflation. The bad news is that, in contrast to the crises of 2008 and 2020, the solution is to remove liquidity. Increasing interest rates have already tamed risk appetite and will reduce economic activity, increase unemployment, and, likely, lead to a recession.

Although higher than usual, the volatility we are experiencing is very much in line with

[1] Please see page 8 for a brief discussion about an appropriate yardstick for Highway One Fund and page 9 for a detailed breakdown of contributors to performance.

what a long-term investor should expect. Things that have never happened before happen all the time. A long-term owner of a competitively advantaged business should cherish an occasional downturn. Why? Look no further than what happened to AntCo of Businessville.

Mr Wise, meet Mr Bull

AntCo has successfully operated grocery stores for decades. Tough but fair with suppliers, AntCo offered the very best to their customers at rock-bottom prices.

AntCo steadily grew its market share until two years ago when, in a move that surprised many in Businessville, GrasshopperCo, their mediocre competitor, raised capital through an initial public offering. Mr Bull, GrasshopperCo's Chief Executive, used promising long-term guidance to lure investors. On the roadshow, Mr Bull announced an expansion from grocery to higher-margin verticals. Investors lauded his vision. GrasshoperCo was valued beyond the wildest dreams, making employees wealthy overnight, including Mr Bull.

GrasshopperCo used the proceeds from the initial public offering to plaster the town in advertisements and offer 30% discounts to customers, new and old. The volumes swelled, and the stock doubled.

Mr Wise, the 80-year-old founder and 100% owner of AntCo, was puzzled. How could GrasshopperCo offer discounts greater than shelf-price gross margins? Do tried and tested ways of building a business not apply?

The customers jumped on the discounts, sending AntCo's volume off a cliff. At the same time, suppliers demanded payments on delivery, the new market standard established by GrasshopperCo. The days of financing expansion with suppliers' patience were over.

AntCo's long-tenured employees started leaving, enticed by GrasshopperCo's stock option plans, turbo-charged by the rising share price. The investors did not seem to mind, arguing that share compensation is not an expense because no cash changes hands.

Mr Wise eventually had to raise capital to pay the suppliers. Despite the recent decline in profitability, AntCo had no problem attracting investors. The company owned the stores and the land under them, a quirk that GrasshopperCo's management ridiculed in private conversations, preferring to lease the real estate.

The economic conditions in Businessville sharply deteriorated a year after GrasshopperCo went public. The price of everything from gas to interest spiked, reducing the share of consumer wallets that can go towards groceries. Sensing danger, Mr Bull tried to raise capital. The company had cash to survive a few months. He was surprised that the investors that encouraged his growth ambitions were now asking about profitability.

The economic slowdown and rumours of a failed capital raise sent GrasshopperCo stock plunging. Mr Bull, his luck running out, focused on profitability over growth. A pause in marketing and couponing further crushed the volumes. The stock declined further, angering employees whose tax bills exceeded the value of the shares received as compensation. Employees lost faith in the company and demanded payments in cash.

Cash-strapped and nearing bankruptcy, Mr Bull reached out to Mr Wise to explore a merger. Mr Wise politely listened but decided against Mr Bull's proposal.

GrasshopperCo eventually failed to pay the leases and filed for bankruptcy. AntCo remained the only grocery retailer in Businessville. Mr Wise used the increase in volumes to improve the terms from the suppliers, earning the highest return on capital on record while still charging rock-bottom prices.

Trigger-ready Club

The best way to prepare the Highway One Fund for volatile times has nothing to do with predicting what the economy will do. We will not sell our holdings, hoping to repurchase them cheaper. Likewise, we won't trade complex products to make up for the broader market's fall.

I prepare for volatile times by researching businesses with the hope of adding them to our Trigger-ready Club. Members of the Club are companies whose ecosystems and competitive advantages I have observed for years. I have followed in real-time what their management said and what transpired. The number of companies added to the Club is my primary measure of productivity.

I am ready to shoot when the market offers us one of them at the right price. Investing in businesses you have been following for years is like marrying someone you have known for a long time. You know what you will get. The ultimate filter – time – is on your side.

Contrast this approach with an alternative so compelling that I practised it for years – investing immediately after completing the research. Unfortunately, this approach is starting to feel like getting married at 5 am at a chapel in Las Vegas. What sounds like a good idea crumbles under the weight of time.

The slow and steady approach seems inefficient until the market offers those businesses at the correct prices. We don't need board meetings or site visits when that happens. Instead, we can snap them up at a moment's notice.

During the second quarter of 2022, the Highway One Fund invested in three companies from the Club.

Interactive Brokers

Interactive Brokers ("IB") is a global brokerage that offers access to a wide range of markets, instruments, and tools at a substantially lower price than its competitors. Since its founding in 1993, it has earned the trust of two million customers with $300bn in assets. Its clients are individual investors, proprietary traders, financial advisors, introducing brokers, and funds, including Highway One Fund.

The firm can offer low-cost, high-quality services because it focuses on automation and eliminates non-essential expenses. IB earns from commissions and interest income. Commissions per account are volatile and minor compared to interest income from margin lending, securities lending, and deposits.

Zero-interest rates in the recent past have obscured how cash-generative IB can be when interest rates normalize. As a result, I expect profitability to blossom in the coming quarters, despite reduced commissions from elevated levels. On the other hand, a prolonged recession can decrease client activity, appetite for leverage, and the growth in new accounts.

Earnings power is growing slightly slower than the number of accounts (annualized monthly growth rate in June was 20%). Incremental customers tend to be less active and affluent than the average customer. Diminishing return from a new account is not a cause for concern, given the pace of the growth and profitability per account.

Thomas Peterffy, IB's founder, the majority shareholder and executive chairman, has centred the company's culture around risk management, engineering, ownership, and cost-consciousness. Much like a bank uses deposits to make loans, Interactive Brokers uses unutilized client cash to lend to other clients. Assets purchased serve as collateral. IB's most significant loss from this activity came when the Swiss franc broke the 1.2 floor against the Euro. Uncollectable margin loans cost the firm 2% of capital.

The founder insists on retaining earnings to boost credibility. Although Interactive Brokers is conservative with capital allocation in the short-term, long-term benefits of a fortress balance sheet will likely be worth it.

Liberty Broadband (Charter Communications)

Charter Communications ("Charter") is the second-largest cable operator in the US, with 32 million customers and 55 million homes passed. It delivers four services to residential and business users: high-speed data, television, telephone, and mobile.

In the US, the high-speed data offering by cable operators rarely competes against a similar product. Charter's infrastructure is prohibitively expensive to replicate. Overbuilding is incredibly labour-intensive, and permits take time. An entrant that overbuilds Charter's footprint would compete with an experienced incumbent that already has customer relationships with multiple service lines. While abundant cheap money has increased fibre deployment plans across the industry, higher interest rates and tight labour markets should scale back those ambitions.

A more immediate impact on Charter is coming over the airwaves. T-Mobile's nationwide 5G home internet offering is winning customers in areas where Charter successfully took share from DSL operators. Rather than taking customers from Charter, T-Mobile prevents Charter from growing as fast as possible. T-Mobile's offering is simple, inexpensive, and sufficient for many users' present needs. A driver of substantial volatility in the short term, T-Mobile's offering is not a cause for a concern longer term. As T-Mobile's vastly more profitable mobile customers use more data over time, the airwaves will have less capacity for home internet, forcing the company to prioritize.

In 2018 Charter started rolling out its mobile offering, bundling it with high-speed data to reduce churn. Charter maintains coverage using a mobile virtual network operator agreement (MVNO) with Verizon when the customers are on the move. However, most data consumption on mobile devices happens on Wi-Fi when users are sedentary. Charter's ability to offload traffic to its cable infrastructure allows it to price significantly lower than competitors (including Verizon) while remaining profitable and saving consumers a ton of money.

The most significant risk for the business is a more challenging regulatory environment that would control prices or force Charter to share its infrastructure. I think this is unlikely. The government is currently subsidizing cable operators to offer internet to areas that are otherwise uneconomic to serve.

Another threat to our returns comes from substantially higher interest rates. The leveraged buyback model, in which Charter uses all free cash flow to repurchase its shares while servicing a significant debt load, works less well when Charter must refinance at 10%.

Charter's subscriber count will grow in the coming years as households across the US use more devices and consume more data at faster speeds. Revenue growth will boost free cash flow per share.

Please note that we invested in Charter via Liberty Broadband, a listed company controlled by John Malone, whose sole asset is its controlling stake in Charter. In addition to having our fate tied to Mr Malone's, we get exposure to Charter at a significant discount.

Wayfair

I started reading about Wayfair at its initial public offering in 2014. While I didn't invest at the time, I kept following the business. The founders seemed unique – Niraj Shah and Steve Conine worked together for 25 years, were still of ripe age, owned a substantial piece of the company, and did not take advantage of other shareholders through elaborate compensation structures.

A decade ago, Wayfair was a hodgepodge of home item websites that gathered traffic through search engine optimization and drop-shipped products to customers. Since, the company has aptly allocated capital by building a national brand, growing its logistics capabilities, and improving the shopping experience. Wayfair has evolved into an e-commerce brand that offers all things for the home and delivers most of them within 48 hours. It still owns no inventory but now forward-positions the goods of its Asian suppliers in their warehouses to facilitate speedy delivery.

Over the years, it became apparent that the horizon on which the co-founders are operating is genuinely long-term. Their patience contrasts with their average investor, who typically rents the stock for 15 days. We first invested in Wayfair in February 2020 and sold during the spectacular rise in its share price during 2020 and 2021. In May 2022, we got another opportunity to purchase a significantly larger business at a lower price than in 2020.

The opportunity did not come without uncertainty. After growing 49% in the first quarter of 2021, Wayfair's sales declined by 14% in the first quarter of 2022. Increasing economic uncertainty is forcing consumers to rein in spending on discretionary items. I expect Wayfair to cut costs and reduce the marketing budget. After a period of turbulence, I suspect Wayfair will keep moving toward its long-term goal of becoming the largest home goods retailer in the developed world. The prize is worth well over $7bn Wayfair was worth at the time of our purchase.

Highway One Fund Partner Meeting – October 20th, 2022

I am excited to finally welcome current and prospective partners to Belgrade for Highway One Partner Meeting. I hope the meeting will be informative and casual, allowing you to ask tough questions and meet fellow partners.

The meeting will start at 2 pm on the 20th of October and go on until 5 pm. I will stay around as long as you have questions.

Registrations are now open. I will share the venue with the registrants in a separate communication. I am looking forward to seeing you all in person.

If you cannot make it or have questions, please contact me anytime.

Sincerely,

Stefan Culibrk

Appendix – 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 decline in EUR compared to the USD during the first half of 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 long 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 1 – Contributors to returns from April to June 2022

Company	Contribution	Return	Weight
Interactive Brokers	0.0%	2.3%	4.7%
Wayfair	-1.4%	-42.5%	2.5%
Liberty Broadband	0.1%	8.6%	1.7%
Management fee	-0.2%		
Interest	-0.2%		
Fund operating costs	-0.1%		

Source: Bolder Group, Interactive Brokers
Data as of June 30th 2022