INVESTOR LETTER

THIRD QUARTER 2020

A Note to Investors from Michael T. Nowacki:

When we started Saga Partners in late-2016 Joe and I both wanted to create a strategy similar to how we invest personally, so that we could put our money into it and allow others to invest alongside us for a small management fee.

At the time, we also began a consulting relationship with Umberto Fedeli, owner of one of the largest independent insurance agencies in Cleveland. He makes his own investment decisions, but he wanted our assistance with research, idea generation, and to bounce ideas off. While we are independent owned and managed, our office is located inside The Fedeli Group office space because we enjoy working with Umberto and the environment is unique—every day different local business and political leaders come for lunch with Umberto and enjoy 6-course Italian cuisine, cooked by his sister and mother.

In 2019 Joe ended his formal consulting relationship with Umberto Fedeli to focus all his work efforts on the Saga Portfolio. His focus and dedication are exemplary; I could not have found a better partner. My work with Umberto continues and I value the relationship. He has been a business mentor in many ways. He has also been a source of investment ideas, client referrals, and new friendships.

Umberto has a few strategies, one of which focuses on companies with high growth and another that focuses on some of the best businesses in the world (Google, Facebook, Visa, PayPal) and buys them when they are out-of-favor or at attractive prices. We have had great success in these strategies over the past four years (I can share the results at your request) and for the past two years I have had employee retirement funds, corporations, foundations, and ultra-high net worth people express interest in investing into these other two strategies. Last year I decided to formally build out the strategies and allow others to invest. I launched the *Durable Growth Portfolio* Oct 1st, 2019 and the *Wide-Moat Growth Portfolio* just launched Oct 1st, 2020.

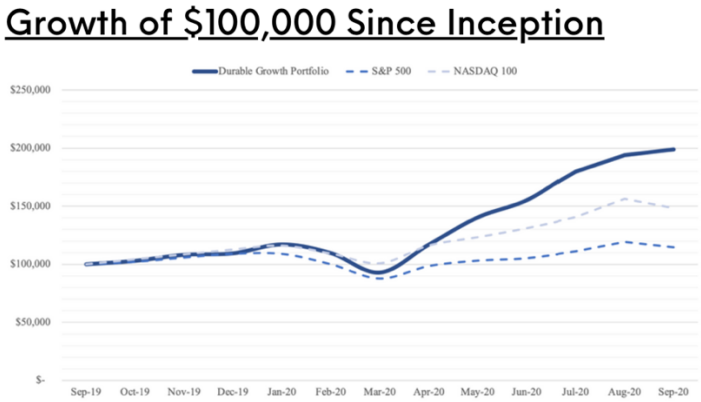
In August 2020 Richard Chu joined our team. He has all the qualities we were looking for in a new team member: obsession with investing, love of learning, ability to do deep dives into companies, hardworking, passion for investing into companies with high growth, independent thinking, a great personality and good character. You can follow his blog and see some of his writings here: https://richardchu97.substack.com/ Richard works on all three portfolios, assisting in idea generation, research, and internal discussions about positions and allocations. However, his main interest and focus is on the *Durable Growth Portfolio*.

We do not want to confuse current investors or prospective investors if we are offering other strategies under the Saga Partners LLC name. Therefore, we have changed the name of the parent firm to Luca Capital LLC: https://www.lucacap.com/

Saga Partners will still have its own website (https://www.sagapartners.com/) and Joe will continue to work exclusively on that portfolio. I will continue to be co-manager of the Saga portfolio. The *Durable Growth Portfolio* and *Wide-Moat Growth Portfolio* will be under the parent company Luca Capital LLC.

3Q20 Results

During the third quarter of 2020, the Durable Growth Portfolio increased 28.2% gross of fees. This compares to the overall increase, including dividends, for the Nasdaq 100 and S&P 500 of 12.6% and 8.9%, respectively. Since inception on October 1, 2019, the Durable Growth Portfolio returned 98.8% gross of fees, compared to the Nasdaq 100 and the S&P 500 of 48.8% and 15.1%, respectively.



Monthly Performance (gross of fees)

Year	Jan.	Feb.	Mar.	Apr.	May.	Jun.	July.	Aug	Sept	Oct.	Nov	Dec	Durable Growth	Nasdaq 100	S&P 500
2019										2.97%	4.97%	1.23%	9.4%	13.0%	9.1%
2020	6.97%	-6.37%	-15.21%	25.86%	19.99%	10.6%	15.9%	7.8%	2.6%				81.7%	31.7%	5.6%
Cumulative return since inception													98.8%	48.8%	15.1%

Interpretation of results

September marked a return of volatility after a significant summer rally as election season approaches. While macroeconomic factors can have a very real impact on the stocks and earnings power of our companies over the short term, it has no bearing on our investment decisions. Thanks to commission-free online brokerages like Robinhood, it has never been easier to buy and sell stocks. However, we have learned that often the best thing you can do is to do nothing at all. The speed and severity of the March crash and subsequent recovery shocked even the most seasoned investors, and unfortunately created fear that drove some people out of the market at the most opportune time in a decade to be purchasing stocks. We can often be our own worst enemy when it comes to making investment decisions, especially quick judgements, as it's all too easy to fall victim to common behavioural biases. One of the most common being loss aversion – the pain of losses hurt more than the satisfaction from gains; however, in order to achieve anything worthwhile, there will always be ups and downs along the way. Short-term volatility is inevitable if you desire significant gains and should not be equated with long-term risk. Take Livongo (LVGO) for example, one of the best-performing stocks this year and a significant position in the Durable Growth Portfolio. It went public last year and promptly entered a severe downtrend, declining over 60% from its all-time highs made shortly after IPO. Nothing in the underlying thesis had changed, yet such volatility would have certainly caused most investors to reconsider their conviction.

However, there is a difference between being patient and being stubborn. It is very possible that our original thesis on an investment may turn out to be incorrect, at which point we will not hesitate to sell. There are a number of valid reasons for doing so, whether it be a significant deceleration in growth, if we believe its moat has been breached in some way by competitive pressures, industry headwinds, management changes, if the valuation becomes detached from reality, or if we find a significantly better opportunity.

We may not be able to predict the future, but we aim to always make the best decision with the information we have today. To aid in that process, we analyze what made companies succeed or fail in the past, then apply our learnings to come up with four distinct filters to evaluate new and existing positions:

1. Business
2. Management
3. Durable Growth
4. Price

We break down these criteria more deeply on our website, but the core of our process is finding companies with durable moats, visionary leaders, and large addressable markets, that can provide attractive returns with a 10-year outlook. Once we identify a business that fits our criteria, our target holding period is forever ("Forever Investing"). A thesis is rarely made or broken in a quarter, so we zoom out from the stock's day-to-day gyrations and focus solely on the performance of the underlying business, giving our companies time to execute.

You may notice that the majority of our filters are qualitative. While we do believe that any company can be overvalued, the market has historically undervalued companies with durable competitive advantages because it expects the ROIC to trend towards average over time. However, the best businesses can often earn returns far and above their cost of capital for much longer than can be reasonably expected. Therefore, these businesses tend to trade at multiples that would be considered expensive by traditional metrics. However, the market can realize this opportunity and apply a much higher valuation on these companies, hence discounting their future returns to a more average return.

One example of this is Snowflake (SNOW), which recently debuted at an EV/S of over 175x. Although future returns might still be attractive, a significant amount of upside has already been captured. If we assume P/S drops 83% over the next 10 years to 30x with modest share dilution of 3.5%, in order to achieve a 15% annual return, Snowflake would have to grow sales at a ~41% CAGR to a $13B run rate. Snowflake is an exceptional company in a massive market so it might prove to be undervalued even at today's prices, but we prefer to find more compelling opportunities.

Screening out or selling companies solely based on high multiples can lead investors to miss some of the greatest long-term compounders. On the other hand, low-multiple companies that appear to be traditionally cheap can be overvalued and produce poor returns because they lack a

durable moat or growth of intrinsic value. The purpose of a moat, after all, is to ensure that the intrinsic value of a company is not going to be eroded over time by competition.

While rapidly growing companies typically have high valuation multiples, it is not to say that it is impossible to find a high-quality business at cheap multiples. In fact, our best performer, Livongo, was trading at merely a 4x EV/S multiple based on our 2022 estimates when we first purchased it. It has since seen significant valuation-multiple expansion. These opportunities are rare, and frequently come in the form of misunderstood or unique companies. When you analyze a company in an established market like endpoint security, it's easy to gauge the TAM and forecast an appropriate CAGR by looking at industry reports and consulting experts. When you have a totally new category like Applied Health Signals, especially one at the intersection of two industries, it becomes much harder to estimate its potential. As the company continues to execute and the market better understands its potential, it rewards it with multiple expansion.

While our independent research and process may result in contrarian positions, we do not purposefully seek to be contrarian—often the best opportunities are the obvious winners in their space. Ultimately, growth of intrinsic value is the primary driver of long-term stock performance and multiple expansion is just the cherry on top.

Conclusion

We are honoured to have the opportunity to manage our investors' hard-earned capital. The success of the strategy relies on finding investors that share our philosophy and trust our decision-making. To this end, we endeavour to be as transparent as possible with our theses. Joe and I openly share our thoughts and insights on Twitter, which we've found to be a great resource to communicate with our investors and connect with other likeminded people. I also frequently write deep dives on my personal blog: https://richardchu97.substack.com/.

We hope you find this update helpful in understanding why we invest in the companies we do. If you have further questions about our investing process, holdings, or anything else, please feel free to also reach out to us through the contact form or by email: richard.chu@sagapartners.com.

Sincerely,

Richard Chu

Positions

I recently published a research article on the health insurance marketplace GoHealth (GOCO) which you can read here. I'd like to dedicate this letter to going more in-depth on another top holding, and one that I am personally the most excited about: Livongo, which is merging with Teladoc Health (TDOC) in a deal set to close in Q4'20.

Livongo and Teladoc: Building a Better Health System

This document will be updated tomorrow with my full 16-page thesis.

Disclosures and Disclaimers

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The S&P 500 and S&P Smallcap 600 are unmanaged indices of widely held common stocks. The S&P 500 and S&P Smallcap 600 Indices are not available for investment, and the returns do not reflect deductions for management fees or other expenses.

Luca Capital, LLC is an independent, fee-only, registered investment advisory firm, providing portfolio management to individuals, retirement plans and institutional investors.

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