July 2022

Dear Fellow Investors,

The Consumer Price Index registered more than 8% year-over-year growth in March, April and May. It's been forty years since the US economy last faced this level of inflation, which was then quashed only after the Federal Reserve aggressively raised rates that caused a recession. Investors today are concerned about a repeat of that playbook. Broad-based share price declines that began in the first quarter accelerated in the second quarter, most severely among growth stocks. As lower prices tend to offer higher prospective returns, we acquired additional shares of several existing holdings, and we initiated two new investments, for which our theses are described below.

New Investments

PayPal (PYPL)

PayPal is a leading payments company with 426 million active accounts globally that collectively generated total payment volume of $1.25 trillion in 2021. PayPal is the dominant digital wallet in North America and Europe, accepted by 76% of the 1,500 largest online retailers. It has a big lead over the competition; the next most prevalent wallets are Apple Pay and Amazon Pay with acceptance rates of 27% and 15%, respectively. In the last three years, active accounts have increased 60% and customer engagement has increased 23% to 45 annual transactions per active account. In a virtuous cycle, account and engagement growth leads to more merchant acceptance, which leads to still more usage.

Like PayPal's core business, user growth of the company's Venmo peer-to-peer payments app also spurs further growth. Venmo increased volume 44% in 2021 to $230 billion, representing staggering growth from $7.5 billion of volume transacted in 2015. The business is dipping further into banking and brokerage services including credit card, check cashing, and trading cryptocurrencies. This additional layering of services increases customer retention and presents a long-term opportunity to take market share from traditional banks.

The company's massive footprint enables it to successfully distribute ancillary services that work to further engage its customers. PayPal launched its Buy Now Pay Later (BNPL) offering in August 2020 and by December 2021 it was generating $13 billion of annualized transaction volume, on

3238 Prospect Street NW | Washington, DC 20007
917-991-6860| www.sweetbaycapital.com

par with leading independent BNPL provider Affirm Holdings (AFRM). It took Affirm ten years to achieve similar scale.

PayPal shares had fallen 60% in the six months prior to our investment because of decelerating transaction volume trends as stimulus spending dried up. While the pandemic caused uneven growth trends, transaction volume has doubled in the last three years. Investors are also concerned more generally about growth stocks due to the likelihood of rising interest rates to combat inflation. We paid 23x management's guidance for 2022 free cash flow, a 36% discount to the shares' five-year average cash flow multiple. I view that as a reasonable price to pay for a global payments leader with mid-teens organic revenue growth. At that multiple I believe our annualized return in the shares will approximate the revenue growth rate.

Compass (COMP)

Compass, Inc was founded in 2012 as a modern take on the traditional residential real estate agency business. In an industry that has been slow to adopt new technology, Compass provides agents with a unique platform that includes cloud-based customer relationship management, marketing, and client service software. Due in part to efficiencies enabled by this technology backbone, Compass agents are more productive than their competitors. In the last four years, a 51% increase in the average number of Compass agents has led to 102% growth in Compass transactions, compared to 8% growth in industry transactions. The company enters new markets aggressively by leveraging its up-market brand and defined value proposition to attract the best agents. Those agents generally thrive at Compass and lead to retention rates exceeding 90%, considerably better than the roughly 70% rate for the industry. In New York and Washington, DC, the company's two oldest markets, annual retention rates are in the mid-90s even though the initial incentive contracts have expired for more than 75% of those agents.

New markets totaled 25 in 2021 and the company is now in 69 markets representing nearly half of the US population. In the last three years, its national market share has increased from 1.1% to 5.6%, and it has over 25% share in its most mature markets. It has taken share from more antiquated agencies including RE/MAX and Realogy (Century 21, Coldwell Banker). Compass has nearly doubled its agents in the past two years even while offering fewer incentives. The majority of agents who joined Compass recently received lower commission splits compared to their previous brokerage, a clear indication of the perceived value of the Compass brand.

The company's recipe has so far been successful. It has the top market share in five of the eight markets in which it has operated for more than five years. And it appears to have a long runway of growth ahead as it penetrates more new markets. It is in the very early states of rolling out title and mortgage services, both of which are natural add-ons with essentially zero customer acquisition costs because prospective customers will already be working with Compass agents. Achieving attach rates in line with peers could boost free cash flow by 30-40% above what Compass will generate from its core real estate agency business.

3238 Prospect Street NW | Washington, DC 20007
917-991-6860| www.sweetbaycapital.com

Its balance sheet is in good shape with nearly $500 million of net cash and disciplined spending. Cash burn in 2021 was $79 million, a 20% reduction from 2020 when half as many new markets were launched. Sales have almost tripled in the last two years and grew 25% year-over-year in the most recent quarter. Since its April ’21 IPO the share price has declined by more than 60% primarily due to expectations the Federal Reserve will increase interest rates to fight inflation. Management expects to turn 8-9% of revenue into free cash flow in 2025. Assuming revenue growth continues to moderate to a mid-teens rate and share count dilution continues at its current pace, free cash flow per share would be over $2 in 2025. At our purchase price the shares traded for less than 3x 2025 free cash flow. Upside in the shares is clear if management is anywhere close to accurate with its projections.

Please reach out to me directly with any questions about your account(s).

Cordially,
Ted Crawford

3238 Prospect Street NW | Washington, DC 20007
917-991-6860| www.sweetbaycapital.com

Important Disclosures:

The views expressed are those of Sweetbay Capital Management, LLC as of July 2022, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security. Information, research and data throughout the report and on each new security is acquired through multiple sources, including company websites, annual reports, presentations, SEC filings, and conference call transcripts; third-party research from UBS Financial Services, Yardeni Research, and Value Line; and news articles from various sources including The Wall Street Journal, Financial Times, Bloomberg, and The Economist. While the information presented herein is believed to be reliable, no representation or warranty is made concerning its accuracy.

Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. The New Investments section describes each new security in which we initiated a position for most accounts during the referenced period. Every security may not have been purchased for each client based on the timing of a particular account opening, or based on assessed needs of a particular account. Management risk is the risk that the investment techniques and risk analyses applied by the investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to the manager in connection with managing the strategy. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. Investors should consult their investment professional prior to making an investment decision. This material contains the opinions of the manager and such opinions are subject to change without notice. This material has been distributed for informational purposes only. Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission.

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended by the adviser) will be profitable or equal to past performance levels. The S&P 500 is an unmanaged index used as a general measure of market performance. You cannot invest directly in an index. Accordingly, performance results for investment indexes do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results.

3238 Prospect Street NW | Washington, DC 20007
917-991-6860| www.sweetbaycapital.com