



GILDER GAGNON HOWE & CO.

Letter to Clients  
Second Quarter 2020

August 25, 2020

Dear client:

This is the second of what we hope to be a limited number of pandemic letters. The firm has adapted to remote work and is mostly functioning well. However, without access to conferences and tradeshow, we are still working to adjust our process of finding new ideas.

We are doing okay, but the United States really isn't. When we wrote our Q1 letter in the middle of May, the country had stopped the spread of the virus by shutting down. However, we've emerged from that lockdown without a strategy to limit the virus spread and what is holding up the stock market is that we are instead treating the economic symptoms of a prolonged partial shutdown with stupefyingly massive stimulus. The good news is that as a country, we are rich enough to pay the economic bill from this lack of political leadership. Meanwhile, the researchers and doctors looking for solutions are soldiering on and appear to actually be a little ahead of schedule, with numerous vaccines in stage three trials and basic medicine reducing the fatality rate by over half with more advanced therapies coming this fall. It is hard to predict the path from here to there, but as we wrote last quarter, we think the pandemic will end. In the first quarter, we were laser focused on the virus because we felt others were underestimating it. Now with the news talking about little else, we're trying our best to focus at least some of our attention on companies and ideas that are less well understood.

My job is to take risks. If I can find good risks, we tend to do well; if I don't find good risks, we don't do that well; and when I make mistakes, we can really lose a lot of money. Most of our performance during the quarter was driven by the decisions we'd previously made, from positions that we added in prior years and then from our adaptations to the virus in Q1 2020. Luckin, Fastly, and Wirecard are three positions that we added in 2018 and 2019. Luckin was our largest loss, and Fastly and Wirecard were among our largest winners.

Luckin Coffee, which we wrote about in our Q4 2019 letter, was a bad risk. Companies using mobile technology to revolutionize the sale of branded goods -- especially food are exciting. When we learned about Luckin's technology-infused coffee chain growing in a matter of months to be as large as Starbucks China, we loved it. Then, in January, a previously unknown

source reported<sup>1</sup> that Luckin revenue was actually far lower than what they had claimed in their financial reports! The previously unknown firm hired over a thousand temporary people to record video of about 20% of Luckin stores for a day, counting the number of orders.

Interesting, but we've done enough of this type of work ourselves to know that even if it is accurate, data from a single day can be misleading. We participated in a call with the Luckin CFO and other investors where he explained that the financial controls for revenue were very good since nearly 100% of the revenue came in through the mobile payment platforms WeChat and AliPay and he got daily reports from those external sources. Unfortunately, we chose not to sell, and eight weeks later, Luckin's board of directors issued their own report corroborating the fictitious revenue allegations. We sold the stock down 88% from the start of the quarter and down 64% from where we'd originally purchased it. Ouch.

It's fun to find creative ways to gain insight into a company's performance. Fastly, up 383%, was our best-performing stock during the quarter. Fastly provides a programmable edge computing service for distributing content on the internet. In early May, we read a blog post by the streaming media analyst Dan Rayburn claiming that Amazon had begun using Fastly to distribute a small portion of their content. After a heated discussion with a sell side analyst about how significant Amazon's use of Fastly was, we wrote a quick computer script to check [<https://cdninfoalyzer.ucr.appspot.com/>]. To collect a broad set of samples, we posted the program on Twitter so others could run it from their computers. As the results rolled in, we were amazed to see that from many locations 90% of the bytes delivered from loading [www.amazon.com](http://www.amazon.com) were coming from Fastly! Another aspect that we've noticed about our job is that it isn't enough just to find exciting companies, we need to keep working to develop the sufficient confidence that we can stick with them. The insight from this little program gave us the confidence to stick with Fastly as it rose from \$17 at the start of the quarter to \$40 in May and \$80 ending the quarter. It's a little nuts that Amazon is using Fastly rather than AWS to deliver most of the bytes from their flagship page even more so because it probably indicates that lots of other companies will want to do the same.

While we got taken for a ride with Luckin, we were on the right side of the German payment processing company Wirecard. We shorted Wirecard in February of 2019 after reading an article in the Financial Times by the dogged journalist Dan McCrum. When we looked at Wirecard's financials we were confused by how a merchant acquirer like Wirecard was keeping 1.6% of each transaction for itself when other merchant acquirers like Square, Stripe, or Adyen keep less than half a percent. Reading about Wirecard's history helping gambling and internet sex sites take credit cards, we figured they were earning more because their customers were companies that Stripe, Adyen and Square would not touch because they were skirting

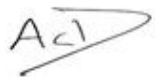
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<sup>1</sup> The report is titled "Luckin Coffee: Fraud + Fundamentally Broken Business" and can be found as of the writing of this letter with an internet search.

international law. Then we spoke with a couple of ex-Wirecard employees, and heard from the ex-head of sales in one region that in the two year period that he had been there, they hadn't closed a single deal and the ex-head of compliance in another region about how a single person tightly controlled access to all the financial information. We shorted it, hoping that Wirecard would get some heat from regulators after Dan's writing encouraged people to look at Wirecard's customer list. It turned out to be much worse, Wirecard, like Luckin, had simply invented billions of dollars in profits and, in fact, was insolvent -- management had forged the bank statement for billions of dollars of assets they claimed on their balance sheet. As the truth came out in April and May, the stock declined 98% and unlike China, where Luckin's CEO is likely to get at most a slap on the wrist and a fine, Wirecard's CEO Marcus Braun and a number of other members of senior management are in jail or on the run.

The Luckin debacle was deeply embarrassing for us and we feel terrible about putting your money in it. However, I think you should be more concerned if we don't have the occasional devastating mistake like Luckin because if we aren't making big mistakes, it probably means we aren't taking enough risk, have become too scared of embarrassment, and are less likely to find more Fastly and Wirecards in the future.

Thanks for your support,

A handwritten signature in dark ink, appearing to read "Acl" followed by a stylized flourish or arrow pointing to the right.

Alex Derbes

We have always reported a single performance statistic, summarizing a range of results. Many factors affect where your account landed in that range. Accounts that missed one or more top performing stocks, or had a larger position in a poorly performing stock, can land at the bottom of the range. The performance of new accounts, smaller accounts and accounts that had significant deposits or withdrawals during the period is particularly variable. Even among the remaining accounts, there is a wide range from the aggregate performance we report<sup>2</sup>.

We derive aggregate performance by totaling the equities in all of the accounts under management and calculating performance (net of commissions or wrap fees) as if we managed one account. This methodology weights large accounts more heavily and is not representative of any particular account. Therefore, we provide the worst performing account<sup>3</sup> in the relevant period to give an indication of the potential range in investment performance. Please look at your account statement for changes in value from one period to the next<sup>4</sup>.

	<b>Q2 2020 aggregate</b>	<b>Q2 2020 worst</b>	<b>FY 2020 aggregate</b>	<b>FY 2020 worst</b>
<b>Margin</b>	64.4%	29.1%	69.6%	31.5%
<b>Cash</b>	50.1%	45.3%	48.3%	37.0%
<b>Retirement</b>	49.0%	8.7%	44.1%	29.9%
<b>S&amp;P 500</b>	9.1%		31.5%	
<b>Nasdaq</b>	12.5%		36.7%	

The companies discussed in this letter were selected because they are representative of our thinking. Since GGHC manages individual accounts, some of the companies discussed in the letter are not necessarily held in every account. Please remember our goal is to build your wealth by aggressively investing your capital over the long term. This approach carries considerable risk and is not for everyone. It requires tremendous patience and commitment in the face of large swings, and has the possibility of failure. At the same time, success can only be measured on an absolute basis. We do not invest with any particular benchmark in mind.

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<sup>2</sup> All accounts, except for non-commission and non-fee paying accounts, are included in the calculation of aggregate performance. Past performance is not indicative of future results. Aggregate performance and the worst performing account are net of all fees, commission and expenses and includes the positive impact of reinvestment of dividends. At the end of Q2 2020, Alex Derbes managed 98 margin accounts, 8 cash accounts, and 49 retirement accounts.

<sup>3</sup> The worst performing account excludes accounts opened within the period, accounts with an equity of \$1,000 or less, accounts that transferred between GGHC money managers during the period, and uninvested accounts.

<sup>4</sup> Non-retirement accounts pay a commission rate of 1.5% per equity trade. Retirement accounts pay an annualized wrap fee of 2.5% to 3% based on account size. See GGHC ADV for details.

While we provide comparative performance of various widely-reported indices to give you a sense of the overall market environment, you should not expect our results to track any one of them. There are material differences between GGHC accounts and the indices shown, as volatility, investment objectives and types of securities differ.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks. The S&P 500 is a market-capitalization weighted index containing 500 widely held companies. The NASDAQ Composite is a market-weighted index that measures all stocks listed on the NASDAQ Stock Market. The Russell 2000 is an index of the smallest 2,000 companies in the Russell 3000 Index, as ranked by total market capitalization. All index results shown are calculated on a total return basis with dividends reinvested. Index results do not reflect the deduction of any fees or expenses.

You can access the GGHC Privacy Policy and our Firm Brochure, Part 2A of Form ADV and our Form CRS on our website at [www.gghc.com](http://www.gghc.com). This letter is intended for you, our client. If you would like to share it, please contact Caroline Bailey - [cbailey@gghc.com](mailto:cbailey@gghc.com) and we will gladly provide a copy to the intended person.