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Dear Investors,

2020 is a year we'll undoubtedly remember. We witnessed structural shifts that have and will continue to influence all aspects of our daily lives – everything from how we interact with each other to how we purchase and consume products and services. Ongoing secular trends, many of which were already in place before the pandemic, accelerated.

Before we dive into these changes, we would like to update you on Absoluto Partners' first 18 months. As we mentioned in our first letter, we intend to use our letters to keep our investors updated on business developments at our firm.

While we are satisfied with our achievements to date, we feel we are just getting started on our journey, and we're a long way still from reaching our aspirations. Our results over the last year were driven by the coming together of our team, continued refinement of our investment process, and our sole dedication to managing the fund (one of the reasons we started Absoluto Partners).

We currently have 25 employees, split between our Rio de Janeiro and Greenwich, CT offices. We hired new talent in 2020 and were very pleased with the quality of young talent reaching out to us. In February 2020 we started our US operations, which now totals four investment professionals. The high level of synergies and engagement between our investment teams leaves us enthusiastic as we look forward – in 2021, we will launch our Global Fund.

In August 2020, twelve months after the fund opened to investors, we closed the fund to new investments. We are fortunate to have been able to attract a high-quality investor base, mostly families and individuals that are old friends and long-time supporters.

Another attribute of this year we'd like to highlight is our close interactions and relationships with the companies we've invested in. Given how rapidly 2020 evolved, maintaining a close dialogue with management teams became an even more important pillar of our investment process. We're proud of how our investee companies conducted themselves through the pandemic – looking after their employees, acting on their social responsibilities and in turn reaffirming their own businesses as even stronger and more resilient.

ESG was also topical, and it is interesting to note the relevance this theme gained across our investment universe. Though many ESG principles were already part of our investment process, we created a framework to explicitly incorporate the key tenets into our research process. This framework helps us understand how each of our investments individually score on ESG, without employing a top-down "thematic" approach. We had many interesting interactions with our investee companies on the topic and will continue to observe and, where possible, support the ESG agenda, particularly inside our own firm.

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THE LEGACY OF THE CRISIS

Moving on from our business update, let's discuss our learnings from last year. If we could summarize it in one sentence it would be "the world has become omni". From the very early days of the pandemic, it became clear to us that entire industries and professions would need to quickly adapt and embrace new distribution channels in order to survive – from retail to restaurants, from personal trainers to doctors. The need to survive, coupled with the power of technology, was a powerful force to drive change. Latent seeds of disruption that had been present all along reached a tipping point, and found their way to the forefront.

New habits were formed and people suddenly realized how much easier and more productive their lives could be. As life gradually returns to normal, it's hard to know which specific behaviors are permanent and which are only temporary. Either way, it's evident that the pandemic exposed society to new ways of interacting with each other and with businesses, many of which, we believe, are here to stay. It appears to us the changes most likely to persist are those that drive productivity gains or a better customer experience. Looking at our own profession, conferences, meetings and roadshows have likely structurally changed and people will probably take fewer work trips as they incorporate technology into their meeting workflow – especially given the traffic in Brazilian cities!

DIGITALIZATION AND THE CHALLENGES FACED BY INCUMBENTS

In our view, the pandemic will drive two key shifts in the corporate world – a dramatic acceleration of digital transformation, and increased consolidation. Starting with digital transformation, we see this phenomenon manifesting itself in a variety of ways, such as the marked increase in eCommerce penetration, companies rapidly prioritizing long-term digitalization initiatives (such as software implementation or cloud migration), or the new ways companies are engaging with customers and delivering their products and services. As Sheryl Sandberg, the COO of Facebook, noted on US eCommerce penetration, we saw "four years of change in less than 100 days".

The abrupt need to digitalize starkly revealed companies' ability to adapt, innovate and execute. Leadership, culture and technology were critical variables in determining success. Satya Nadella, Microsoft's CEO, articulated just how important it is for companies to adapt: "the next decade of economic performance for every business will be defined by the speed of their digital transformation."

Incumbent companies tend to have a hard time innovating. For established companies, sacrificing short-term profits, be it driven by a revenue model transition or higher investments, is often at odds with executive compensation structures and public market expectations. On the other hand, companies that truly understand and genuinely embrace the need for change across the entire organization often benefit in the medium- and long-term.

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While the benefits weren't always apparent at the time, companies which had previously invested in digitalization ahead of the curve are now reaping the rewards of this long-term mindset, including Magazine Luiza (brick and mortar to digital), Natura (developed social commerce digital tools for its consultants), and Renner (transformation to multichannel). Conversely, sectors in which competition has been more limited and where incumbents enjoyed a more dominant position have had trouble adapting – the Brazilian banking sector being a case in point.

Highlighting the challenge faced by more mature companies, Clayton Christensen in his book "The Innovator's Dilemma" points out that success is intrinsically difficult for organizations to sustain. Established companies have a tendency to iterate and improve on existing products and services (which in turn often become increasingly complex) with an eye to optimizing for the largest financial return at the time. Newcomers, on the other hand, have a blank slate to focus on, offering simple yet elegant solutions with strong customer propositions that target a large addressable market, thus quickly gaining scale and eventually disrupting entire industries. Incumbents often respond by looking to maintain, improve or simply protect the status quo rather than pivoting – thus the "innovator's dilemma".

From the incumbent's perspective, the existence of an already large base of satisfied customers makes it seem incoherent to pursue new solutions or technologies (the ROI on innovation is perceived to be lower than it actually is). Meanwhile it's an obvious decision for newcomers, who have no pre-existing business to protect, to pursue these new solutions and technologies. This in turn creates the backdrop for new, potentially superior innovations to replace existing solutions, thus threatening the incumbents' entrenched position. This dynamic was particularly evident during 2020, when old habits were challenged and people were forced to interact with each other and with businesses in new, innovative ways. As PayPal's CEO Dan Schulman put it: "The pandemic has both accelerated as well as exposed a number of trends that were already existing, taking that gradual acceleration and fast forwarded it maybe three to five years. These are trends that are now accelerated, and in my mind, are never coming back. I think it's a new paradigm that we're going to enter into."

Technology typically evolves faster than the speed at which consumers adopt new innovations – old habits are hard to change, and "Moore's Law" doesn't apply to human behavior. Social distancing, however, forced changes in habits at a rate never before seen. Companies which were forward-looking and evolved ahead of their customers saw their prescient investments pay off, while the competitive disadvantages of more established, slower-moving companies became evident. A good illustration of this is the large-scale investment many eCommerce companies had made into logistics in prior years, in anticipation of higher eCommerce penetration in future years. These companies were well positioned to address the surge in demand and delight their customers, accelerating the pace of share gains from competitors, particularly traditional channels. Mercado Libre and Magazine Luiza, who had invested heavily into logistics the past few years, are clear beneficiaries of this. The CEO of Magazine Luiza, Frederico Trajano, compared the impact on the sector to the Gulf War for CNN or the Arab Spring for Twitter.

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As discussed in our last letter, the culture of “newcomers” is another competitive advantage – characterized by horizontal structures, ownership mindset, quick decision-making, collaboration between co-workers and a clearly defined purpose for stakeholders. Most important, we observe that the challenger companies who have had the most success put the customer at the “center of everything”. In an ever-evolving environment, knowing your customers well and having their trust is essential to preserving and deepening the relationship. Since the beginning of the pandemic, we have observed that the companies who were best able to adapt their relationship with the customer and keep them engaged are the ones who gained the most market share.

Though it’s difficult to predict the pace at which these trends will continue, we have few doubts they will normalize at higher levels than before the pandemic. The sheer number of customers and companies which had a chance to experience new and improved functionalities enabled by digitalization for the first time, with their better convenience and speed, will likely drive continued increased usage – creating a virtuous cycle for the penetration of digital tools in our daily routines.

THE UNFOLDING OF THE CRISIS: MORE CONSOLIDATION

On the topic of industry consolidation, it became evident to us early on how difficult this moment would be for more fragile and less capitalized companies. For such companies, downsizing and business closures seemed inevitable. The disruption to key revenue streams required strong balance sheets and access to capital that many companies and entrepreneurs did not enjoy.

As we emerge from the crisis, additional challenges have become apparent. First, the recovery was not “V-shaped” for everyone, given mobility restrictions and shifts in consumer behavior. Supply shocks in local and global markets severely impacted supply chains. Scaled companies with more purchasing power with suppliers were once again advantaged; the capital intensive car rental business is an example of this, where management’s ability to scale down and efficiently employ capital was crucial to their success.

Further, many traditional small and medium sized businesses struggled as they were either still early in their lifecycle, or had not yet begun their digital transformation process, leading to an even more severe downturn to their businesses. This dynamic is less prevalent within public companies as they have significantly better access to capital markets and also tend to be the higher quality, larger and more stable businesses in their respective industries. As John Donahoe, Nike’s CEO succinctly noted, “these are times when the strong can get stronger.”

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IMPACT ON THE INVESTMENT PROCESS

Our belief is that both the digital transformation and consolidation trends discussed will remain over the coming years. To quote Bill McDermott, CEO of ServiceNow, “the genie is out of the bottle, it’s never going back in, and digital transformation is going to continue to accelerate.” As a result, we are even more acutely focused on identifying those companies that are engaged in such transformation.