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Dear investors,

In this letter, we discuss a frequent and relevant topic in our investment process: the implications of having a core shareholder in the companies in which we invest. At Absoluto Partners, we value this shareholder structure because it promotes long-term alignment, among other benefits that we explore in this letter. Yet the presence of such a shareholder also creates important risks, which we examine in detail.

We will address this subject in two sections. First, we outline the main characteristics and advantages of ownership structures that feature a core shareholder. We also deal with a particularly relevant topic that follows this model: key man risk. In a second letter, we will present several examples in which a core shareholder was pivotal to a firm's ability to make transformational decisions.

THE CORE SHAREHOLDER

The core shareholder can take different forms. In most cases, this role is played by the founder—or by a family member of a later generation—who serves as an executive or board member (e.g., Localiza, Mercado Livre, Nubank, Raia Drogasil, Rede D'Or, among many others).

Less frequently, the core shareholder is an executive whose trajectory and leadership has become strongly associated with the company even though the individual owns a smaller equity stake (e.g., Jamie Dimon at JPMorgan, Bob Iger at Disney, or historically José Galló at Lojas Renner in Brazil). A third, hybrid model is the partnership structure in which a group of senior executives jointly controls the company—BTG Pactual being the prime example.

Regardless of the corporate structure specifics and the context in which the core shareholder operates, certain essential characteristics define them: a notable role in building the company, deep knowledge of the business, influence over day-to-day management, and the establishment of a corporate culture aligned with long-term goals.

The clearest benefit of having a core shareholder is the **long-term orientation** in decision-making, especially during critical times. When the decision-maker, or someone who directly influences them, is also a long-standing investor, decisions naturally tend to maximize the company's structural profitability and ensure its continuity, even if such decisions are detrimental to short-term results.

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We would also highlight that core shareholders typically exhibit a higher **risk appetite** and a greater willingness to pursue bold decisions. For instance, in recent years we have observed that “founder-led" companies have shown significantly more fortitude in driving their digital transformations compared to their competitors. Today, these companies are beginning to reap the rewards of such investments, finding themselves in an even stronger competitive position than they were prior to taking bold action. It is also worth noting that, in companies lacking this type of leadership, decisions that require greater risk-taking may be postponed — or not made at all — ultimately undermining the business’s enduring competitiveness.

Moreover, the presence of a **strong corporate culture** is another positive trait that we observe more frequently in companies with core shareholders. These individuals are typically responsible for shaping the culture or, at the very least, for ensuring that its values are preserved and effectively applied in day-to-day operations. Companies with a strong culture tend to display greater team cohesion and agility in decision-making, contributing to more effective execution. In fact, the sharing of common values and a strong sense of belonging prove to be particularly valuable during times of adversity. Additionally, when combined with inspiring leadership, a strong culture translates into a greater ability to attract and retain talent, especially when supported by high governance standards and meritocratic processes.

We also note that the **influence and expertise** of the core shareholder are valuable assets for the organization. Typically, these individuals bring a unique industry background that provides differentiated perspectives and strengthens the foundation for strategic decision-making. They are also widely respected and admired, which facilitates connections with other leaders and organizations. This human capital contributes to the attraction and retention of highly qualified professionals and can, at times, be a decisive factor in forging strategic partnerships and driving M&A processes.

Finally, another important outcome is the **stability in governance**, which ensures consistency in the long-term strategy. As a result, the company's course is preserved even during periods of turbulence, often before the outcome of the adopted strategy is not yet evident.

As a point of curiosity, we’ve observed that even in more mature markets like the United States — where corporations are the predominant model — there has been an increasingly notable presence of companies with core shareholders. For instance, companies at the forefront of disruptive movements often have founding shareholders actively involved in the business — the so-called "Magnificent 7" are a clear example of this. It is also noteworthy that, among the 25 largest companies in the S&P 500, 40% have founding shareholders serving either in executive roles (such as CEO) or as members of the Board of Directors, compared to only 12% in 2005. When narrowing the analysis to the 10 largest companies, 70% currently exhibit this characteristic versus just 10% twenty years ago.

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Finally, it is important to emphasize that we are neither generalizing nor assuming that a shareholding structure of this nature is, by itself, a definitive factor for business success. It is essential to remain attentive to potential misalignments that may arise between the interests of the core shareholder and those of the company. For example, excessive vanity can at times lead to overly patronizing behavior, which may conflict with the objective of maximizing long-term value creation for shareholders. The personification of a company in a single individual can weaken control mechanisms and diminish the quality of the decision-making process if not well-managed. Thus, factors such as the engagement and legitimacy of the leadership, track record, clear understanding of the business's current stage and sector dynamics, and the company's competitive positioning are all critical aspects that must be carefully evaluated.

In the next section, we intend to explore examples where the core shareholder played a key role in successful strategic moves, as well as cases where they were responsible for unsuccessful strategies.

THE KEY MAN RISK

In our view, among the risks arising from the presence of a core shareholder, the most challenging to address is the key man risk — that is, the risk of excessive dependence on a single important individual. This risk materializes when a company relies too heavily on a person whose vision, expertise, and influence disproportionately shape the success of the business. The absence of this key individual can trigger operational instability, loss of stakeholder confidence, disruptions in strategic execution, or even governance crises — particularly in companies where central leadership concentrates critical decision-making, unique knowledge, or strategic relationships [1].

To illustrate this risk, we considered it appropriate to explore the case studies of BTG Pactual and Nubank. Both are relevant investments in Absoluto Partners' history where key man risk is more evident. With this purpose in mind, we interviewed André Esteves and David Vélez, seeking to gain deeper insights into how each addresses this issue within their respective businesses. The conversations were highly enriching and brought valuable reflections, which we discuss below.

ANDRÉ ESTEVES

BTG Pactual presents key man risk through its Chairman, André Esteves, the principal shareholder of the partnership that has controlled the bank since its repurchase in 2009. Esteves' remarkable leadership is a fundamental pillar for preserving BTG Pactual's culture, which is characterized by meritocracy, excellence, and entrepreneurship. His presence is also critical for attracting and retaining talent, contributing to the admirable longevity of the bank's senior leadership. Moreover, the enduring nature of the partnership within the bank's ownership structure reinforces the long-term orientation of major decisions, enabling the execution of unique business opportunities within the sector.

[1] McKinsey (2020) found that companies without a structured succession plan are 30% more likely to experience significant disruptions. Harvard Business Review (2016) observed an average decline of 14% in market value among companies lacking a clear succession plan. Meanwhile, Sustainability (2023) highlights negative impacts on productivity (up to 20%) and innovation (up to 25%) during periods of leadership transition..

In our conversation, the banker echoed the preference for businesses led by reference leadership, while also acknowledging the weight of key man risk under such circumstances.

"Companies with reference leadership are generally better — whether it is a founder, a senior partner in the case of a partnership, or even a long-standing executive, such as Jamie Dimon at JPMorgan or Galló at Lojas Renner. And, as this is true, key man risk also becomes a reality."

Esteves identified two potential risks associated with the eventual loss of the key man: disruption and loss of stamina. Disruption occurs when there is no clear succession plan, which can lead to immediate strategic discontinuity and a loss of focus. However, he believes that with "a bit of discipline," this risk can be addressed.

"Disruption is the most serious risk, although it is easier to avoid. For example, in a family-owned company, in the absence of the core shareholder, the family will fight, the company will lose its direction, the strategy will change... This is a significant risk, especially in family businesses. When you have key man risk, you need to double-check whether, in the abrupt absence of the key man, succession is properly addressed. In our specific case, being a partnership, I believe it is easier to manage this issue. There have been rules established for many years, leadership is shared among several partners, and my shares act as a stabilizing ballast."

According to Esteves, the issue related to stamina is more chronic and structural. In this case, stamina refers to the energy instilled by the core shareholder or executive, motivating the team and preserving the organization's identity.

"If leadership leaves the company unexpectedly, there is a risk that the business will lose its brilliance. It won't affect results over six months, but the company may gradually slide into mediocrity. Loss of stamina is a less damaging issue than disruption for minority shareholders, but it is more difficult to address."

When asked how to address the risk of losing stamina, Esteves acknowledged: "There is no real formula; you have to find people who will maintain that stamina."

"Let's use JPMorgan as an example. There were 'three JPMorgans': grandfather, father, and grandson. Jack, John's son, institutionalized and internationalized the business. Stamina was maintained across generations. Another example is the Pinault family, where François-Henri, the founder's son, played an almost equally important role as his father in building the business."

The solution begins by identifying those who act as culture carriers within the bank. Even though BTG Pactual's partnership naturally values professionals who are aligned with the organization's culture, it is not trivial to identify those who are truly capable of propagating it on a daily basis.

"Sometimes a person is an excellent head of a business unit, but as an inspiring figure to disseminate culture and drive long-term thinking, the necessary skill set may be somewhat different. We need to develop people who have that — and sometimes the solution lies further down the organization. It doesn't happen naturally; you have to actively seek out these people."

In this context, we observe that the search for new leadership has become a topic increasingly present on Esteves' agenda.

"Another angle related to this matter: it is important for the bank to have more spokespersons; today, the concentration is still very much on me and Roberto. This is something we are working on, not so much due to succession planning, but because the bank has become very large."

Although Esteves is now less involved in certain areas as the bank grows, he notes that the bank's culture has remained intact.

"Looking 10 to 15 years ahead, I do not intend to change my lifestyle. But we are increasingly paying attention to the new generation. This is something firmly on our radar. In fact, in the case of the bank, it won't be a second generation — it will be a third."

DAVID VÉLEZ

Vélez founded Nubank in 2013 and remains a central figure in the company as CEO and Chairman. His clear vision regarding the future of the financial system — where technology would become the predominant distribution platform — and his determination to put this belief into practice were crucial to Nu's success. It is difficult to think of many individuals who have so directly transformed an established industry as Vélez has done to the Brazilian financial system.

Naturally, we believe that David's leadership is essential as Nubank continues to expand the business. His presence is vital to preserving the company's culture, which is one of Nu's key competitive advantages, particularly due to its obsessive focus on the customer[2]. Moreover, as Nu has grown, it has attracted world-class talent, largely driven by Vélez's leadership and vision. The company's long-term orientation is also influenced by his presence, as illustrated by Nu's significant investments in platformization and geographic expansion. It is common to hear Nu executives say that the organization is playing the infinite game.

In order to address the key man risk that arises from his relevance to Nubank, Vélez emphasized the central role of the company's culture.

"The founder must ensure that there are culture promoters at every level of the organization, so that even when the founder is no longer present, there are defenders of the company's values and strategic purpose. The risk associated with a leadership change is lower if the culture is already deeply rooted within the organization. This means that if a new leader arrives and is inconsistent with the culture, the culture itself will reject them, just as our body rejects a virus. There comes a point where the culture becomes sufficiently informed to accept only a certain type of leader."

[2] The first pillar of Nu's culture is: "We want our customers to love us fanatically." It is worth noting that we have heard from several current and former Nu executives that the company's customer-centric focus is unequivocal across all major decisions, a fact that is consistently reinforced by various strategic choices made by the organization.

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Additionally, it is critical for the organization to have a well-defined succession plan. The significant importance Nubank places on this topic stands out among other companies we follow.

"Our Board has succession as its number one priority. We have a clear plan, which includes several different successors in mind — including successors who may not be ready yet but could be in a few years. In an ideal world, of course, all would be internal candidates."

Vélez also highlighted the challenge of finding exceptional managers who are also inspiring leaders, noting that it is rare to find executives who excel both in execution and in propagating culture.

"Leadership is about inspiring others. So, we are talking about finding good leaders who can sell a vision to a group of people and who can motivate and energize them. While there are many professionals who are excellent at execution and others with great capacity to inspire, finding someone who combines both qualities is uncommon. To make the matter even more complex, you cannot evaluate a succession candidate based on their current role, because when the role changes, they are playing a completely different kind of game. It's like trying to choose the best runner by watching someone swim."

Vélez believes that the search for successors must be active — in other words, it does not happen organically. For this reason, it is important to closely monitor the development of talent within the organization.

"You can assign challenges to potential successors, making them operate under different conditions or subjecting them to specific tests. But it is impossible to fully simulate what happens when someone assumes leadership of the organization. And this is one of the reasons why succession has been so difficult for many technology companies."

As an example of this challenge, Vélez mentioned conversations he had with Bob Iger regarding Disney's succession process. On the other hand, he highlighted the successful CEO transition at Microsoft to Satya Nadella.

Finally, Vélez emphasized the importance of carefully calibrating the founder's time at the helm of the business.

"The tenure cannot be so short that it compromises the consolidation of the vision, nor so long that it causes stagnation. The departure should be planned in a way that allows for leadership renewal without losing the legacy. As far as I'm concerned, I would be happy to stay for a long time. And I hope the Board wants me to stay for a long time. But I will be the first to say if, at some point, I am no longer the right person to lead the organization — or if there is someone better suited for the role."

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MITIGATION STRATEGIES

Despite the marked differences in organizations, it was noteworthy to see observe several commonalities emerge during our conversations with both leaders. In light of this feedback, we've synthesized a few key points that, in our view, should be part of the strategic agenda for companies exposed to key man risk:

- Strong and Widespread Culture: The existence of a strong organizational culture, with clearly defined values and purpose capable of mobilizing the company, is essential to ensuring that business success is not tied to specific individuals. In companies exposed to key man risk, it is even more critical that this culture is deeply rooted, so that its preservation does not wholly depend on the active presence of leadership. In this sense, it is crucial to identify who the internal promoters of this culture are, as this becomes an essential credential for individuals considered to assume the company's leadership.

- Active Succession Process: The replacement of a key man rarely happens spontaneously. It is fundamental that the organization proactively addresses this issue and treats it as a strategic priority, especially at the Board of Directors level.

- Leadership Development: Many of the skills that define a successful leader can only be observed once the professional assumes a leadership position. Thus, an individual's performance throughout their career is not a guarantee of success when elevated to a leadership role. In fact, executives are often not naturally prepared to take a significant leadership role in a business. In this context, it becomes fundamental that the organization dedicates attention to the development and nurturing of professionals with the potential to assume such roles in the future. Succession by an internally developed leader is especially desirable in companies with a strong organizational culture — a common characteristic among companies with core shareholders.

Thus, we believe it is critical to carefully observe how companies with core shareholders manage their succession process. Ideally, succession should occur gradually, with careful planning in the selection of new leadership, and once the successor is chosen, a well-managed transition period. Whenever possible, this transition should include a progressive withdrawal of the core shareholder — for example, by transitioning from an executive role to a position on the Board of Directors.

A notable example of successful mitigation of key man risk is Apple, which faced significant uncertainties following the death of Steve Jobs in 2011. Jobs was perceived as the driving force behind the company's innovation and identity, and his departure initially generated market volatility. However, a robust organizational culture built over many years combined with a well-structured succession plan allowed Tim Cook to assume leadership effectively. Under Cook, Apple not only maintained its position but also expanded its dominance into new markets, demonstrating that key man risk can be overcome when a company is well-prepared to transcend its founder.

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In contrast, the leadership transition at Disney highlights the risks associated with a poorly executed succession process. Bob Iger, whose initial tenure as CEO ended in 2020, was widely recognized for his ability to lead strategic acquisitions — such as Pixar, Marvel, and Lucasfilm — which consolidated Disney's position as a leader in entertainment. While the initial transition to Bob Chapek was planned, it is apparent that Chapek did not embody the same strategic vision, which gradually led to instability. Disney faced criticism for operational decisions, such as price increases at theme parks and tensions with content creators, as well as a decline of approximately 30% in market value between 2020 and 2022. Iger's return in 2022 highlighted the company's dependence on his leadership, reinforcing the importance of preparing successors who can maintain stakeholder confidence. This case also illustrates the challenge of evaluating, ex ante, the suitability of executives for the top leadership position, further emphasizing the need for proactive and early attention to succession planning.

Finally, it is important to note that we do not disregard investments in companies with dispersed ownership structures (corporations). In such cases, we prioritize companies with a strong corporate culture, one that has been shaped by previous generations and preserved by current executives, ensuring a decision-making process focused on long-term value creation.

CONCLUSION

As investors, we value companies that combine the strength of core shareholders with strategies that ensure their long-term sustainability. Key man risk highlights the need to align the unique influence of these leaders with robust preparation — through a well-established culture, clear succession plans, and well-prepared executive teams. This discussion also brings important lessons for ensuring the longevity of Absoluto Partners itself.

Thank you for your trust,

Absoluto Partners