

**Thanks for doing this, Arne. First up: Any opening thoughts on the market?**

These types of corrections are totally natural, even if they're uncomfortable. I've been in markets for more than 40 years, and I've lived through all sorts of crises: The '87 crash, the dotcom bust, the 2008 meltdown, and so on. And many more of far less severity along the way. There's always a crisis that shakes investor confidence at some point, people sell, quotes plummet, and so on. And then this is what always happens next: The market seems to bottom when people least expect it to, and then a couple of years go by and people begin to say, "If I had only bought more then..."

So that's just the nature of these things. The rhythm. It's all very natural, and market prices are just not worth getting too worked up over. I coach this to the team, but the only thing that matters over the long-term is the companies you own, and their ability to compound out in value. The truth is, unless the time period is long enough, a stock price contains very little useful information. This is especially true when markets are going berserk.

This is the beauty of long-term investing. You can ride out the inevitable ups and downs the market throws your way. Timing these fluctuations is almost impossible, especially over several cycles.

I'll say this, too, by the way: In my experience, the best companies always rip back. Sometimes incredibly fast. Whether it's higher interest rates, inflation, a recession, it doesn't really matter. The key, in my mind at least, is to just own fabulous businesses that are compounding at a steady pace. Eventually, the market should get it right. I happen to think that once some of these macro issues subside, you'll see a V-shape recovery in the stock prices of certain businesses.

On the other hand, some weaker businesses may never see the valuations they saw in 2020 or 2021. And that's a good thing, by the way. There was too much froth in the market, too much speculation. But for the winners in this cycle—wow—it's like, 'game on.' I think the next decade is set up for some incredible opportunities. Some businesses are set up to absolutely crush the competition. It's winner-take-all. And I think we're going to see that reflected in the stock market soon enough.

**And how about the portfolio? Historically speaking, we're at a relatively high point of concentration.**

Yes—I agree. It's unorthodox, for sure. It's unconventional, even. But it's all by design. For a lot of Wall Street, their incentive is to grow assets, to keep assets, that sort of thing. In other words, their goal is to just not rock the boat. They design portfolios that look good on the surface, and I think many end up just being overly diversified. And the results are often average at best.

So—I don't want us to be average. And I certainly don't care about looking pretty to outsiders. My goal is to do what's in the best interest of our *current* investors. And I don't waste a second thinking about how to please prospective investors. That's how I operate. My incentive is to take care of our partners. Period. That's it. Full stop. We'll see who puts up the numbers in the next couple of years—and who doesn't.

Second, we always like to think with first principles. When I look at the portfolio, I think “Is this portfolio designed to protect and grow our assets? Do I have a high level of conviction in it?” We start from scratch each day and approach the portfolio with this mentality. As our investors likely know, starting earlier this year, I trimmed down a few positions to focus our capital on our best ideas. And I like the texture of the portfolio right now.

So, yes, we're concentrated right now. Will the portfolio look like this in the future? Almost certainly not. In the past, we've owned as many as about a dozen businesses at a time. Right now, it's three core positions in the flagship funds. But when the time is right, I think we'll go back to owning five or seven or even 12 positions again. Or maybe even more. I'm sure we'll talk about it more in this conversation, but we're just in a unique situation right now. A good one, I should add.

Outsiders might perceive this level of concentration as unusual, but it's like Buffett said, you wait for the fat pitch. We got a fat pitch, so we're taking our swing. The portfolio is designed 100% for the benefit of our partners. That's it. I know I could design a more technically attractive portfolio for outsiders, but it's just not what we do. Our goal is to grow our partner's capital. That's all.

**A question from one of our investors: “I’m curious to know how things are looking for Arne deciding to invest in other things. Obviously Tesla is the big play, and he’s taken some Spotify and dabbled elsewhere, but no other big bets. Does he see anything brewing, or is this the way for now?”**

Good question. Our goal is to construct the best performing, highest conviction portfolio we can. We’re *always* looking at new companies, new industries—so absolutely. For example, if you look back to the midpoint of our performance track record, the portfolio was dominated by Amazon, Netflix, and Facebook. Now it is Tesla, Spotify, and Amazon. If we see something that’s worthy of our investment capital, we’re ready to size up new positions. As I always coach the team, ‘We only own #1.’ We don’t play around with second or third best companies in a category. We’re happy to be patient, too. If we get in at the second or third inning of a company’s growth, that’s fine. But they’ve got to be the #1, dominant winner. That’s what matters.

The concentration in Tesla is a unique situation, and it’s a reflection of my conviction in their market dominance relatively early in the cycle. I view owning Tesla in 2022 like owning Apple in 2007... or maybe even 2003... or maybe even earlier. And this company is going to be much, much bigger than Apple, in my opinion. In my investing career, I have never come across a position that I not only thought had the potential for massive returns moving forward, but one that I had the utmost conviction in – even more so than Amazon.

I think we’ve barely scratched the surface of what this company can become. And so my view: We *have* to own it in size. My projections for Tesla’s growth are far, far beyond the consensus view right now. I like to stay calm and dispassionate about these types of situations, but the truth is I’m giddy. I think we could be set up for a couple of years of strong growth, far beyond what Wall Street is expecting.

Over the next few quarters, I think we’re going to see a swell of activity around Tesla in the investment community and on Wall Street. In my mind, it’s not a question of *if*, it’s a question of *when*.

I know I've probably said this before in previous Q&As or letters or phone conversations, but I continue to think Tesla is destined to be Wall Street's favorite stock. It's got all the right ingredients—fast growth into vast, global end markets, rapidly expanding gross and net margins, a wide moat, endless demand for the product, and crazy potential upside from energy storage FSD, bots, AI—none of which I think are priced into the stock.

I know it doesn't look pretty to more conventional outsiders, and I know the stock is hated by some pockets of the investment community, but A) I don't care about looking pretty and B) the best investments are almost always hated for a period of time before they become consensus. Many of the so-called "smart money" on Wall Street wouldn't touch Amazon in the 2010's but had no problem buying it in the 2020s.

The best rewards come to those who wait, by the way. We just need to be in position—and we are.

**Along similar lines, another investor asks: "Does Arne have some new names he is looking at that he would expect to become part of the portfolio in the near future or is he waiting for the IPO of newer companies such as Redwood?"**

Again, absolutely. We've been deep in the research tank on several companies. We've gotten to know Redwood and many others in the disruption of energy markets. We're also doing deep dives in a few more new areas for us, like disruptive healthcare, AR/VR, and synthetic biology.

When I think about the next decade, I think we're just entering a period of enormous change. That's what makes it so exciting, but we can't let ourselves get too excited about any single idea before they've proven to us that they can execute. Consistent execution and a satisfied customer base are two of the most important risk metrics you won't find on a financial statement. So, we like to wait, we like to research, and we'll be there when the time is right.

I should also add that in the new fund, which we launched a few months ago, we're invested in quite a few verticals, from Chinese EV makers to American gaming companies. I like the new fund quite a bit. It's got a few strict parameters around position sizes but it's a nice window into the types of business models we're attracted to.

**One investor asks, “I’d be interested to hear Arne’s view on the biggest risks to his Tesla view.”**

Sure. We read all the negative opinions, and most of them just don’t hold water. A few years ago, I’d say the biggest risk to Tesla was competition coming online. But we followed it closely in case we needed to pivot the portfolio, but it never happened. It’s still not happening. Tesla is just so far ahead, particularly on the manufacturing side.

If you turn on CNBC, which I do not recommend by the way—unless Eric is being interviewed of course—you’ll probably happen to hear one of many sell-side analysts talking about some of the core “threats” to Tesla’s business.

It’s funny. I was watching the movie *Galaxy Quest* the other day with my son—a great film—and there’s this one line that always reminds me about sell-side analysts. The character says, “We’re actors! Not astronauts...” That’s kind of how I feel about many of the supposed experts who talk about the threats to Tesla’s business... they’re not really analysts. They’re just actors who play them on TV.

For those of you who know me well, you know that this work—investment research—is all I do. I probably spend 60, maybe 80 hours a week purely on research. Gave up golf about a decade ago. No more meetings. I’ve devoted myself to this enterprise. And I love it.

Over the last few years, a solid percentage of that time has been on Tesla. I’ve probably watched Tesla’s Battery Day from 2020 about 15 times now. I know it sounds crazy, and maybe it is, but you pick up so much information by just listening and re-listening. There’s also just an incredible amount of passion in the Tesla community that produces some exceptional fundamental research available online, via podcasts and newsletters and videos.

So, as far as risks: Sure, there’s certainly some short-term risks around more Covid-related lockdowns and maybe some supply chain headwinds. Over the long-term, we’re going to be watching the levels of demand and profitability at scale. But nothing I’m too concerned about. I’ve just been incredibly impressed with Tesla’s growth and technical innovations, along with ability to adapt and solve problems time after time. I’m really, really excited for the future. It’s

been astounding to watch. And I think the market is just going to be waking up to it over the next few quarters.

**Another investor wants to get some of your unvarnished thoughts on Tesla's business: The good, the bad, etc.**

Oh wow, where to start? Like I said, I follow Tesla religiously, so there's just so much to talk about. We could probably write a book about it.

I'll say a few things — first, Tesla China is kicking butt. They are showing the world what true manufacturing speed can look like. A few years ago, this was a few acres of dirt. Now it's going to be churning out about a million cars a year. So kudos to Tesla China.

Second—I think the market is making a major mistake about the potential for explosive margin expansion. Behind the scenes, we've been doing a ton of analysis on the costs of each car produced and the unit economics of this business. It's profound. I think Tesla could have a better margin structure than Apple has with its iPhone, on a product that's many orders of magnitude more expensive. Think about that.

The cash flow and net income implications of this are staggering and lead me to believe the most probable outcome for 2024 net income could be around \$50 billion. (Consensus is less than half that figure.)

Any Tesla valuation for today should look forward, not backward, and so then I ask: What's a fair multiple to pay for a company that's growing earnings at this rate? I come up with around 60 times 2024 earnings, which I view as conservative, and that leaves me with a present value of about \$3 trillion market cap, or roughly 3x today's price. Will Wall Street wake up and take this view tomorrow? Probably not, no. But give it a few more quarters and I think they're going to be forced to sharpen their pencils. This provides us with a margin of safety if the market even modestly closes the intrinsic value gap.

So that's on valuation. But the truth is I'm most interested in some of the core engineering and software developments at Tesla. For one, we're hyper-focused on developments of FSD and the application of AI. There's just enormous potential there to leverage Tesla's data. It's a

sleeping giant of the business. The application of AI isn't factored into my near-term profit calculations, by the way. These are opportunities that function as essentially free call options. It's a unique situation—one that I am very happy about.

On the battery front, I've been really encouraged by Tesla's use of the iron phosphate battery. I think the LFP battery chemistries are going to be super-important to the scaling of the energy storage and distribution business. The 4680 roll-out has taken some time, which is frustrating, but I think we'll start seeing real volume production in 2023, which will coincide with the launch of the Cybertruck and the production of the Tesla Semi.

So, we just have many positive catalysts ahead for us at Tesla. As I coach the team, I view Tesla like the racehorse Secretariat. We just keep winning, and the lead keeps expanding. Meanwhile, the stock hasn't really budged in a year and a half, which is building tension. So, we'll see what happens over the next few months, but I'm very, very optimistic about the potential for 2023 and 2024.

**Another investor asks: Why do you think the market hasn't realized Spotify's potential? And what's keeping the stock back?**

It's a frustrating one. Spotify plays the long game. They're investing in the business for growth, but they've yet to produce consistent earnings. And that's intentional and necessary if they want to dominate the massive audio verticals that may have little room for second place. Podcasting, audiobooks, building out an advertising business—all these endeavors require significant capex, which has been a drag on gross margins generated from music. And despite generating positive free cash flow, Daniel likes to run the business at break-even during this period of extended growth.

All of that makes sense to me, but in this market environment, anything that isn't producing profits right now is getting tossed out. So we're going to be patient, but we're also flexible. The next few quarters and years for Spotify are key. Starting next year, we're going to start seeing these investments bear fruit, and we'll be watching it closely.

I think there's a good chance that whenever some of the macro issues abate, and Spotify shows consistent user growth and success in building out the more margin-heavy global advertising business, we're going to see a positive reflection in the valuation. Longer duration assets are not worthless, even if the current market is taking that view. While there has been high correlation between those equities, they will eventually decouple.

As for why the market hasn't come around to the Spotify story just yet, I think it's hard to say exactly. But my sense is that they view it as a "show me" story. Sometimes companies like Spotify simply need to put up the numbers to get a valuation repricing. And I think that's what's going to happen to Spotify over the next couple of years. In my opinion, Spotify should be trading at least above \$300/share today. It's one of the larger deviations in price to value I've seen historically in the market.

**Another asks, "Are you enjoying managing the new fund? The strategy is a bit different"**

Oh, yeah. Like I tell the team, I don't care what the rules are, I just want to win. There's some constraints in the new fund—we've got maximum position sizes, that kind of thing—but my attitude is, 'Sure, bring it on.' I just want to win. Even if I'm playing a game with an arm tied behind my back, I'm still going to try and beat the competition.

**Another question from an investor: "If you had 2022 to do over again, what would you have done differently? What did you learn?"**

That's funny—if I could do 2022 all over again, we'd probably be up a million percent. I'm kidding, of course. The tough years are necessary, and there's no doubt this has been a tough one. For example, we'd been monitoring some potential shorts in the summer of 2021 that, in retrospect, we could have arguably been more aggressive on. Some of them were already down a bunch—I'm talking about the unprofitable "story stocks" that came to market in 2020, 2021 through SPACs. The risk/reward just didn't make sense then to be aggressive on the short side, but of course, that turned out to be wrong. Everything is obvious in hindsight, though. So there's not much use of dwelling on the past. The fact is, I just don't get much information from market prices. There's nothing to really learn from overall market volatility.



What I have learned this year, again, is really how superficial so much analysis on Wall Street tends to be. It's not only superficial, but it's short-term. All the analysts I see tend to be focused on this week or that week, or sector rotations or capital flows. None of that really matters over the long-term. All I care about is the business, and these guys tend to be focused on other stuff. All of that is okay, though. Actually, we have to give thanks. As much as I hate the shallow analysis, I love that it gives us opportunities.

**Any closing thoughts Arne?**

I appreciate all these questions. I have to commend our investors. You are a group of intelligent, thoughtful people. It's a pleasure to be with you on this journey. The next few years could be fantastic for us. I'm excited.

The fact is, I'm bullish on this market going forward. I don't have a crystal ball and I could never say when, exactly, things are going to turn. But when they do turn, I think it can turn quickly, and we'll be there to reap the rewards of our patience.

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