

February 5, 2021

Dear Partners:

The Fund gained ~5.8% in 2020. Since inception in May of 2014, our portfolio has returned ~153.6% compared to the ~128.2% delivered by the S&P 500 Total Returns (our benchmark) as shown below:

	1H 2020	Q3 2020	Q4 2020	FY 2020	Since Inception (5/1/14)
Fund: ¹	(10.74%)	(1.03%)	19.75%	5.79%	153.64%
S&P 500 TR:	(3.08%)	8.93%	12.15%	18.40%	128.19%

Among the most notable moving pieces during the second half, the Fund:

- Initiated positions in Axon (AXON), General Motors (GM), Nordstrom (JWN), Schrödinger (SDGR), and Sprouts Farmers Market (SFM),
- Added to our existing positions in Quotient Technology (QUOT), and VeriSign (VRSN),
- Exited from our position in JWN,
- Exited from several of our put positions, and
- Finished the year with a cash allocation of ~23.6%.

“The markets aren’t the economy,” so repeated the financial commentariat throughout 2020. And by golly, the world’s central bankers seemed determined to make it so. Whether measured in lives lost or livelihoods impacted, the losses were real, substantial . . . and largely ignored by 2020’s “everything rally.”

With “all gas no brakes”² as the prevailing maxim, the over-stimulation of many assets often seemed more inevitable than advisable. Accordingly, the portfolio maintained a more restrained positioning - via cash and bearish allocations - throughout most of the year. Alas, as evidenced by our underperformance, such restraint proved especially costly in 2020.

Fortunately, last year wasn’t entirely about brake tapping. Indeed, our positive finish to the year was testament to the heavy-lifting of several lead-footers in the portfolio. A welcomed bit of oomph, for sure, but a tailwind that left many of our high-growers looking pricier than ever. Despite the possibility that some of these lead-footers may encounter growing pains in the near-term . . . we’ve embraced a white-knuckle approach to date, concluding that it made little sense to trade our greatest asset - a long-term perspective - for the short-term safeguarding of present gains. While such patience is not universally prudent (of course!), it does seem especially so where the direction is positive, plausible, and substantial.

With that in mind, what follows is a brief overview of two such pricey princelings, with an emphasis on

¹ All performance numbers are presented *before* allocation to the General Partner.

² Hat tip: [Andrew Callaghan](#)

the directional factors that suggest a long-term approach should prove quite fruitful.

Pinterest

Pinterest (PINS) likes to say that “inspiration” is the foundation for everything that happens on their site, and as our top contributor in 2020, it’s fair to say we’re plenty inspired.

From its launch in March of 2010, PINS was a site wherein users (i.e., “Pinner”) were encouraged to peruse an unending catalog of images (i.e., “Pins”) related to their personal hobbies and/or interests. Perhaps more important than the discovery of “Pins” for your favorite hobby, is the ability to save/organize those “Pins” into collections (i.e., “Boards”).

Lest the notion of pinners pinning pins to their boards tempt a yawn, let’s skip to the desirable demographics of their “valuable audience” (emphases mine):³

“Pinterest reaches 335 million monthly active users, *two-thirds of whom are female*. As of December 2019, our total audience includes *47% of internet users in the U.S.* . . . this includes *8 out of 10 moms* . . . as well as *more than half of all U.S. millennials ages 18-34*.”

Even better than those impressive demographics is the reason that sort of audience chooses to visit Pinterest in the first place:

“[Pinner] come to discover ideas for just about anything you can imagine . . . Browsing and saving visual ideas on our service helps Pinner imagine what their future could look like, which helps them go from inspiration to reality. Pinterest is the productivity tool for planning your dream. Dreaming and productivity may seem like polar opposites, but on Pinterest, inspiration enables action and dreams [to] become reality . . .”

While inspired users are one thing, inspired advertisers will be the key to realizing shareholders’ dreams. Along those lines, PINS offers a particularly compelling alignment with the intent-driven efforts of marketers (emphases mine):

“Getting inspiration for your home, your style, or your travel often means that you are actively looking for products and services *to buy* . . . [since “*advertisers are in the business of inspiration*”] . . . *relevant ads don't compete with native content on Pinterest; instead, they are content* . . . Pinner use our service to get inspiration for things they want to do and buy in their real lives. *This journey from ideation to action takes them down the entire purchasing process* . . . [this enables advertisers to] have the opportunity to put relevant promoted content in front of Pinner at every stage of the purchasing journey . . .”

³ Per 2019 10-K

Unsurprisingly, PINS was a prime beneficiary of the unique dynamics of 2020. Monthly active users grew by 37% (to 459 million), and with a 48% year-over-year increase in sales, 2020 marked yet another year with impressive top-line growth. And yet, despite ongoing success in growing average revenues per user (a.k.a. “ARPU”), PINS’ global ARPU of \$4.26 still remains downright tiny compared to the ARPUs delivered by their social media peers. Case in point: the ARPUs at Snapchat and Facebook were recently ~\$9 and ~\$32, respectively.

At a plump year-end valuation of ~16x estimated sales for 2021, PINS is likely going to require some growing into. That said, many of the necessary pieces are already in place, and ample green shoots are already apparent. For example:

- On the user front, PINS is still in the early stages of expanding internationally, and continues to iterate on a variety of usability and feature improvements designed to keep existing users inspired and engaged.
- On the revenue side of things, PINS continues to implement the unsexy infrastructure and backend tools that marketers need and want (e.g., analytics, automated bidding, etc.), while also integrating the early pieces of PINS’ nascent - but promising - e-commerce efforts onto the platform.

Although certainly less inspiring at year-end levels than at the portfolio’s entry point of ~\$14.90, we remain optimistic that there’s significant runway ahead.

Schrödinger

From inspiration and advertising, to physics and pharmaceuticals . . . grab your coffee.

Schrödinger (SDGR) aims to transform “the way therapeutics and materials are discovered.” To do so, they have developed a computational platform - 30 years in the making - based on a “deep understanding of physics-based modeling and theoretical chemistry.” Why might that be exciting? In short, because researchers can utilize this technology to conduct “computational assays” that enable the design/assessment of molecules *without* the need for more expensive and time-consuming physical experiments.

While improvements in molecular discovery are applicable to anything involving molecules - everything from biologics to material science applications - the combination of cheaper/faster/better is particularly compelling when it comes to the discovery and development of pharmaceuticals. Here’s how the company quantifies these benefits (emphases mine):⁴

Speed:	“Our platform is able to evaluate molecules <i>in hours rather than the weeks</i> that it typically takes to synthesize and assay molecules in the laboratory.”
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⁴ Per 2019 10-K

Scale:	“Our platform can explicitly evaluate <i>billions of molecules per week</i> , whereas traditionally operated discovery projects only synthesize approximately <i>one thousand molecules per year</i> , thereby increasing the probability that we find a novel molecule with the desired property profile.”
Quality:	“[O]ur platform . . . resulted in an <i>eight-fold increase</i> in the number of molecules with the desired affinity.”

Since time is money, a ~50% reduction⁵ in drug design timelines is the sort of value proposition that speaks for itself. And it appears that message has not gone unnoticed: *all* of the top 20 pharmaceutical companies are already customers, and SDGR’s 10 largest customers sport an average tenure of 17 years. To the extent “land and expand” succinctly captures the bullish sentiment here, the “landing” has already happened, and even better, it appears quite “sticky.”

When it comes to the “expand” part of the equation, increasing the wallet share from existing customers is the obvious low-hanging fruit and thus the primary talking point. To that end, SDGR has successfully grown the number of customers with an annual contract value of more than \$100,000.⁶ Better yet, these customers offer yet another indicator of the technology’s “stickiness:” SDGR’s retention rate among these big spenders has remained at 96% (or higher) in each of the last six years.

But to really expand, SDGR’s technology will have to transition from a “nice to have,” to a competitive “must have” among researchers. Given the lengthy and costly realities of traditional drug research/development, that type of transition seems more plausible than predictable. Either way, SDGR is hardly waiting idly for the “inflection point” to be announced. Quite the contrary.

In fact, SDGR’s snowball is already in motion. Their computational capabilities are growing more capable and more powerful with each passing day. As the technology improves, so does the value proposition. And therein lies the real kicker: because SDGR licenses the same software to others that it also employs for its own benefit, this virtuous cycle should be good for the customers, and downright fantastic for SDGR. They are already capitalizing on that reality:

- **Partnerships:** Via collaborations on various drug discovery efforts, SDGR has received research-related income and the potential for future milestone payments, royalties, etc., if/when such research is further commercialized.
- **Wholly-owned:** In the spirit of putting their money where their mouth is, SDGR has also started to invest in wholly-owned research programs with the intention of “out-licensing” the results to maximize the commercial potential.

At the portfolio’s cost basis of ~\$55 a share, the portfolio paid ~32.5x the estimated \$100 million of software segment sales in 2020. That’s pricey territory by just about any measure, but potentially less blush-worthy if there’s more to this story. And though SDGR has had a number of successful

⁵ Per 2019 10-K: From 4-6 years via traditional drug design approaches, to 2-3 years via SDGR’s computational drug design approach.

⁶ Per [December 2020 Company Overview](#): From 103 at YE 2017, to 131 at YE 2019.

collaborations in the past, a recently announced collaboration with Bristol-Myers Squibb (BMY) seems to suggest software revenues are indeed only one part of the story, and perhaps not even the best part, after all. According to the 8-K:

- **Collaboration:** SDGR and BMY agreed to a four-year collaboration in the discovery, research, and pre-clinical development of “small molecule compounds for biological targets in the oncology, neurology, and immunology therapeutic areas.” Under the agreement, SDGR will be responsible for the discovery “of small molecule compounds directed to five specified biological targets.” Once SDGR has completed discovery, BMY will thereafter be responsible for further pre-clinical and clinical development.
- **Intellectual Property:** BMY has agreed to assign to SDGR “all of its rights, title, and interest in any know-how and patent rights in any inventions that relate to [SDGR’s] physics-based computational software platform.” (i.e., SDGR’s cash register *and* technology will benefit from this collaboration)
- **Financial Terms:** In addition to an upfront payment of \$55 million, SDGR is entitled to receive up to “\$2.7 billion in total milestones.” Further, SDGR is also “entitled to a tiered percentage royalty on annual global net sales of ‘Licensed Collaboration Products’ ranging from mid-single digits to low-double digits.”

All things considered, a pretty impressive vote of confidence by BMY in a company with a preannouncement enterprise value of just ~\$4 billion. How’s that for expanding wallet share?

In Closing

With the Federal Reserve “not even thinking about thinking about raising rates,” emboldened investors have been eager to prove Mr. Powell isn't the only one capable of retiring his thinking cap. And with so much stimulating going about, and even more proposed, this virulent strain of “non-thinking” often seems like the most viable explanation for much of the froth and folly on display in today’s markets.

While only time will tell how this all plays out, I’ll be doing my best to ensure we land on our feet. To each of you who have supported me over the years, a sincere thank you for your continued trust and encouragement along the way.

As always, please feel free to email or call with any questions or concerns.

“If you want a happy ending, that depends, of course, on where you stop your story.”

Orson Welles

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