August 2020

Letter to our stakeholders:

Initiation: celebrating three years with full hearts and minds[1]

Dear stakeholder,

We decided to create this letter to share with our stakeholders (investors, entrepreneurs, team members, and other interested parties) our thoughts regarding our past and plans for the future. As we intend to keep this ritual for the years to come, we expect it to be an interesting exercise to contrast the letters we write today to the reality as it unfolds.

In July, Shift celebrated its 3-year birthday. It is a remarkable feeling for the founders, that started the company with no support, very little cash and no known "last name", but with strong convictions. This letter comes with excellent timing, as our company (and whole world) experienced rough and transformative times in 2020's first half. We feel that, with this year's learnings, Shift has matured deeply, while maintaining most of its original convictions (and others "shifted" into new ones). We now know a lot more about investing and management than when Shift was founded and the opportunities in growth investing have proved to be larger than anticipated.

We always thought that a major part of our business was *people*. We have repeated that sentence several times to our first backers. Writing this letter, it is rewarding to reflect upon our development and notice that, as we gain maturity, we perceive there is another equally important part, in addition to *people*. We understand it as the *project* and describe it as the aggregate of vision, culture, processes, and team. To us, there is no such thing as the "Midas touch" in investing. Only by having the right set of people dedicated to strong and inspiring *project* we can generate consistent high-performance results in the long term. During this year, we have made strong efforts to add *project* to the *people* and to the convictions that were present since the beginning. We will try to make this clearer along the letter.

* * *

The past months

Since the Covid crisis began, we have experienced different feelings and reactions. At first, fear of unexpected outcomes to our portfolio companies took over. We worked around the clock to assure that our companies were out of risk and taking necessary measures/pivots to succeed in those highly uncertain times. During the following weeks, around mid-April, we noticed a strange behavior in the entrepreneurship/tech ecosystem: strong founders were pivoting with incredible speed and outstanding results. This showed us, at that time, that there were interesting silver linings. At that point we decided to accelerate our venture prospection activity, believing that our boldness would be rewarded. As uncertainty faded – by mid-May – we understood that the main behavioral and tech trends that guide our investment thesis had been intensified by the new outlook. Many startups thrived, occupying gaps left by the slow-moving incumbents.

As we conclude August – 5 complete months after the pandemic started – our companies are healthy, well capitalized and we feel optimistic with an outstanding pipeline of new ventures. We expect to announce a few promising investments these next months.

Long term orientation is core

As we wrote in our past newsletter, we were extremely cautious with new investments in the second half of 2019 and the first months of 2020. The excessive optimism (in other words, *hype*) of tech investing was a

Note: *1 - To address a broader public and safeguard confidential information, the website version of this letter is slightly different from the one shared in first-hand with investors* distraction to what really matters: deep analysis, valuations, execution capability and risk/reward prospects. It is clear to us now that staying out of that euphoric investment cycle was an assertive decision. Despite the persisting effects of the Covid crisis, we now believe this is a better time to invest in new ventures. Valuations have been adjusted to more acceptable levels across many industries, there is less distraction in the ecosystem, entrepreneurs have been put to test, revealing much hidden information, and Covid is becoming a "known" risk.

With an increasing comfort with the Covid-related market risks and less *hype*, there is lesser "unknown" risks and a more solid risk/reward relation is to be expected looking forward.

We are very thankful to have started Shift at a young age. The main asset we have is time. This allows us to work without *FOMO* (fear of missing out) on opportunities, preventing us from falling for questionable assets (very common in the VC industry). As we began our journey, we set out to build our history with strong fundaments, that we believe will shape our business and potentially our industry. With time on our side, we decided to a bold move towards loyalty with our stakeholders, building a performance-based investment model that fits what our investors expect and what we believe is the future of investing. A core focus on the long term does not mean we will work lightly in the short term. It means that we work aggressively but with our decisions patiently oriented to the long term – allowing us to have fewer biases and look at Shift as a long-term project, improving our market timing and principled decision making.

The year of 2020 has confirmed another trend for the long term: growth investing is here to stay (local and global). During the crisis, growth has proved to be little correlated to other asset classes and more resilient than anticipated. Due to low interest rates and decreasing investment returns, patient capital is migrating to growth-oriented investment thesis (VC, PE and growth public equities). As patient capital for growth becomes largely available, the thesis is more likely to pay off. Ultimately, two major drivers of success in growth investing are *patience* and *capital availability*.

But it is not without risks. In growth investing, the positively skewed returns mean that investment philosophy will be key to differentiate winning horses and successful investment firms from all the others. That is why *project* matters so much.

Pipeline management and adverse selection

We have worked hard to improve our pipeline processes and origination capacity to respond to <u>what we believe</u>. We believe that capital concentration (and hands-on support approach) will be one of the main drivers of our investment returns on the long term. To have a more concentrated portfolio, we need to invest less, but more assertively. This is only possible with (i) a very strong origination activity and (ii) a deeper than usual analysis. We know how big the challenge is, given that volume and depth are never in sync. In short, we found out that:

$$Investments = Volume\ (qnt.companies) \times \%\ Conversion \times \frac{1}{Depth} \times \%\ Structuring$$

Looking back, we perceive that (i) our conversion is low because we are picky, (ii) our depth of analysis is <u>really deep</u> and will remain so. These two variables are the ones that ensure that no bad deal is done and are the core of our investment philosophy. Therefore, to maximize our investment ratio, we need to work on the other two factors: increasing the volume of origination and being creative to maximize deals through out-of-the-box structuring capabilities, instead of following traditional playbooks. By maximizing those, we can increase output without losing quality/assertiveness.

Regarding volume of origination, we have been working hard to improve the processes and the results have been great, as the graphs below suggests:

<u>Number of new leads:</u>

Intentionally removed for confidentiality purposes

<u>Number of meetings taken with new ventures:</u>

Intentionally removed for confidentiality purposes

In 2020, we have met with more than 1 new venture per business day (totaling 239 companies year-to-date), highly above our goal for the year. This has brought us to an excellent position in terms of pipeline, with 35 companies currently under analysis, an all-time high.

There is more to it: management model and exploration

We have consistently focused on developing special projects at Shift that operate differently from our VC strategy. These projects are those that demand significant management skills from our team and offer an upside that is more correlated to our day-to-day execution. In terms of investment models, these can be greenfields, brownfields, acquisitions, or venture builder/entrepreneur in residence. Through those, we are confident that we will develop management/real life experience that will be instrumental for our vision – and set us apart!

In addition to our master-franchise of Bluefit gyms in Brazil's Midwest, we have also partnered with AgroGrains, an agribusiness company that has commercialized Brazilian specialty seeds abroad for many years. They are one of the most relevant sesame traders in the country, and our 50/50 partnership aims at professionalizing the company's management through people, tools, processes, capital, and expand operations to (i) multi-product and (ii) verticalization to processing/value-add products. It is a significant challenge and will be a great stress-test for our management model. We have deployed two full-time team members focused on the operation and one partner that will guide and follow-up weekly with the operating team. We are still mastering the ideal operating model to be deployed in our special projects and expect to have a solid model soon.

Another experiment is on track. In February, Shift received a high-profile entrepreneur (2 successful exits) as an entrepreneur in residence (EIR). The goal was to deep dive on markets and business models to launch a new venture in the education industry. The partnership is generating excellent results (and quite a few learning experiences) for both parties and resulted in the creation of Scaleup School, a digital university focused on the real entrepreneurs. In Brazil, there is a staggering 52 million entrepreneurs. Those recur to Sebrae (national institution for entrepreneurship support) or niche courses to satisfy their educational needs. Quality, reach and prices are not adequate for their learning needs.

The results of the skills acquired through these projects are already seen on a day-to-day basis in form of deep and practical interactions with entrepreneurs, better analysis and more value-add on our backed companies. In our view, to constrain our investing activity to "invest" is a mistake. There is more to it. To be a successful growth investor, one must add transformative value in addition to capital.

With all this in mind, we want to go through our goals for 2020 and a few visions for the future.

Goals for 2020 and beyond

During our last strategic planning session in December we set the goal of investing in 6 ventures in 2020. At this moment, we have invested in none. However, we do not see it as a failed half year. Our pipeline's key performance indicators are as healthy as they have never been, and the quality of companies is outstanding. We are optimistic that we will succeed in executing a few investments (3 to 5) in 2020, maintaining our highly selective standards and investment philosophy, that is proving to be effective. With our increasing access to capital, we intend to pursue larger investment checks, that fit well with our highly supportive investment approach/concentrated portfolio.

We feel that we must insists on our more investor aligned business model, despite the many challenges. This is a very important strategic decision and comes with uncertainties. What we see (and others fail to see) is that our business model/how we earn money/the value proposition to our investors are determinant factors of our investment philosophy. It is all part of the *project.* With the right business model, one can make better decisions, through a complete alignment of interests and no perverse incentives, consequently investing better.

Getting here was tough. We heard many times over that our *zero-management-fee* model would get us nowhere, and that it was not exactly what investors were seeking. We politely disagreed. Sometimes one must be a contrarian long enough to prove a point. The main challenges that we consciously have faced (and have not overcome yet) are (i) how to finance our cash burn operation given that there are no management fees and (ii) how to deal with the consequences that arise with a different business model, from market acceptance and competition to the unknown collateral effects natural to innovation. So far, we have financed our operations through the cash-in investments from the partners and the cash flow from our special projects.

During this journey getting a comprehensive view of the landscape, it is clear now that our investment philosophy, culture, and business model is replicable to other synergistic asset classes. We are encouraging our team and partners to think boldly in this direction. We know that any discovery process comes with a great trade-off of time and share of mind. But it may come with great reward to Shift, our investors and backed companies. Despite being in the financial markets, we operate with a startup mindset. Our goal remains at adding substantial value to our investors through differentiated investment philosophy and be a reference in growth-oriented equity returns.

Talent and culture

To face the intense operational activity and what we expect for the next years, we expanded our team from 6 to 11 people. From those, two new hires are people with extensive experiences in Private Equity, that will add skills and analysis capabilities to improve our investment funnel. We have been fortunate to access a great pool of talents to select the new hires. We chose 5 from over 200 prospects and are excited of being able to attract such high-profile pool of talents given our young brand.

As the new hires complete their first months of Shift, we are very proud from the hard work and faster than usual learning curve.

We finally feel that our culture is generating great results. We are building something unique and offering our team the opportunity of being part of a very ambitious long-term project. They have trusted so far that we are making the right strategic decisions. Our team will work harder, think independently, and set ambitious goals, consistently, until we reach our vision.

For those who have an additional interest about this subject, find here our Vision & Culture deck that was presented to the whole team this past month.

For those who do not have the time, below is a quick review of the Principles we work by and for:

1. We are bold independent thinkers that seek for opportunities where others do not.
2. We treat our investors capital as an invaluable and scarce material, so no investment, large or small, is taken lightly.
3. We praise analytical decision making and excellence as Shift Capital's banner, sword, and shield.
4. We value ownership and leadership at all levels of the organization.
5. We are radically sincere with each other, especially when it is hard.
6. We care for each other deeply and express our thoughts in an empathetic way.
7. We believe that transparency and caution are rewarded on the long term.

With this letter, we conclude the first three years of our journey and kick-off the next phase of the project. We thank the investors that have supported us with their capital, trust and guidance, the entrepreneurs and team members that have trusted our vision and the Sanovicz family that has partnered with these young founders against the odds to shift paradigms in Brazil's investing ecosystem.

Sincerely,

Bernardo, Fernando & João