



Missive

FEBRUARY 8, 2022

Failed Experiments

Dear fellow investors,

We were watching CNBC recently and an analyst mentioned what practically nobody besides us has said. She called Amazon's (AMZN) entry into the grocery business a "failed experiment." Amazon has been very successful with its Prime subscription model in other areas. Why do experiments usually fail, even among companies which have made other experiments succeed? As the stock market grieves the mass destruction of capital in the early stages of the tech/growth bear market, let's delve into this very important subject.

Why did AMZN buy Whole Foods?

When the capital markets price you on sales growth and Totally Addressable Markets (TAM), you must show them where your next big sales growth will come from. The grocery business was a \$385 billion sales category in 2017. AMZN wanted investors to incorporate into their thinking that AMZN would take a big part of those sales, like they did in other major retail sales categories.

What was the immediate response?

The stock market crushed everyone in the grocery business from Costco (COST) to Target (TGT) to Walmart (WMT) to Kroger (KR). They bid up AMZN and anticipated the next wave of "fly wheel" benefits to the company.

What is the reality four-plus years later?

The grocery business has been one the best businesses in the pandemic and AMZN is a big player in the industry, but the revenues from grocery are not relevant to the company. Here is where they stood in 2021 and where they are projected to be by [Supermarket News](#):

Amazon's online edible grocery sales are projected to climb to \$26.7 billion worldwide in 2026 from \$14.5 billion in 2021, a compound annual growth rate (CAGR) of 13%, according to the latest Food and Beverage Sector Report from Edge Retail Insight.

Amazon had around \$470 billion in revenue in 2021. Was it worth it to pick up \$14.5 billion in revenue in online grocery sales?

What was the downside of the failed experiment?

The downside of entering the grocery business was that AMZN woke up sleeping giants like Costco, Walmart and Target. These behemoths had massive nationwide mega-store footprints, just

waiting to be splendid e-commerce distribution locations. They all spent massively on building out their e-commerce capabilities, since they had the strong balance sheets and massive free-cash flow to do it. Today, 80% of Target's e-commerce orders are picked up at the store by the customer. The cost savings versus delivery is big enough to drive an Amazon van through! Did the added control of customers via grocery sales at relatively low grocery industry profit margins move the needle at Amazon? The answer is that it contributes to customer dependence.

What experiments have succeeded for our companies funded by free-cash flow and balance sheet strength?

- eBay (EBAY) created PayPal (PYPL)
- Merck (MRK) invented Keytruda (cancer immuno-oncology)
- Amgen (AMGN) created Aimovig and Repatha
- Simon Property Group (SPG) bought Taubman in the middle of the pandemic

Where do we see potential failed experiments currently?

1. "Clean energy" appears to be a massive experiment driven by political motivation and ESG mutual fund/ETF funding. We believe most clean energy companies or subsidiary companies, which have been funded in the last three years, will die. Their death could be the as most of the dotcom companies.
2. The metaverse looks like a sink hole for capital. Can the tech companies ruin enough young lives fast enough to make a buck in the metaverse?
3. Space travel. Once these mega-billionaires take a massive haircut in net worth, will they be willing to fund their grand plans in space?
4. If you ask Charlie Munger, he'll tell you that Crypto currencies will be a failed experiment. The largest spender on advertising for the 2022 Super Bowl game are the Crypto companies. If you go back and look, the 2000 Super Bowl, in the early stages of the Dotcom bust, was dominated by up-and-coming internet companies that turned into investment casualties.

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5. We've seen massive government spending to bridge the economic gap in the pandemic. Is it "different this time" or will this macroeconomic experiment be a major contributor to ongoing "wolverine" inflation and rising interest rates? The jury is still out on whether that will be called a "failed experiment."

In conclusion, we are much more attracted to the new lines of business which are born out of meeting an economic need than we are in futuristic speculation or euphoric squandering of hard-earned capital. Fear stock market failure!

Warm regards,



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