



Letter to Partners #27

Q1 2025

April 2nd, 2025

Dear Investor,

In the first quarter of 2025, our fund achieved a return of +2.26%, outperforming its reference index, which increased by +1.13%. At the end of the quarter, the fund volume stood at EUR 11.6 million.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 120.54 at the end of the quarter. Since inception, the overall gain is +20.54%, with a compounded annual gain of +2.80%.

Net performance figures (including distributions), after deducting all costs, for the -S-, -R- and -I- tranches:

	-S- Tranche	-R- Tranche	-I- Tranche	MSCI Europe S&M Cap
2018	-2.87%*	-2.49%**	-	-17.22%*
2019	+10.36%	+9.40%	+8.31%***	+30.59%
2020	+22.29%	+20.88%	+21.31%	+5.82%
2021	+35.31%	+34.24%	+34.84%	+24.20%
2022	-38.26%	-38.72%	-38.48%	-22.83%
2023	+0.80%	+0.09%	+0.50%	+11.30%
2024	+6.79%	+6.00%	+6.48%	+5.32%
2025 Q1	+2.26%	+2.05%	+2.16%	+1.13%
Since inception	+20.54%	+14.85%	+19.16%	+29.96%*
Annualized return	+2.80%	+2.13%	+2.85%	+3.96%*

* Since the -S- tranche was launched on July 2nd, 2018 until the end of 2018 (approx. 6 months). ** Since the -R- tranche was launched on September 7th, 2018 until the end of 2018 (approx. 4 months). *** Since the -I- tranche was launched on January 2nd, 2019 until the end of 2019. Note: Due to the different starting times and fee structures, there may be deviations in the performance of the individual tranches. Past performance is not an indicator of future performance.

All data according to BVI method, costs at fund level are taken into account. Sources: HANSAINVEST; MSCI.

Reference index: **MSCI Europe Small & Micro Cap index**; net-return (EUR).

The -S- tranche is closed to new investors. Existing investors can order additional fund units with a minimum investment of EUR 10,000. The -R- tranche can be invested in without a minimum investment amount. In the -I- tranche, the minimum investment amount for new investors is EUR 200,000. Existing investors in the -I- tranche can order additional fund shares without a minimum amount. You can find the respective tranche using the following **ISINs** as well as the links below for further information:

[-S- Tranche: DE000A2JF8Z7](#)

[-R- Tranche: DE000A2JQHQ2](#)

[-I- Tranche: DE000A2N8119](#)

HERTFORD CAPITAL GMBH.

ir@hertford.capital. hertford.capital

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Creating a framework for public market software investments

There are few places in the investment world where the laws of physics seem to bend as much as they do in software. Capital-light, infinitely scalable, and blessed with margins that most industries can only dream of, great software businesses defy gravity for long stretches. But like all great investments, the key is not just to recognize a company's current excellence but to judge whether that excellence is durable - whether the competitive advantages of today will still be intact and even greater a decade from now.

Over the last two quarters, I've dedicated considerable time to studying European software companies - a deep dive initially sparked by three of our UK core holdings and their digital transformation efforts (MAB1, TPGF, and LSL). These high-quality companies are channelling meaningful investments into digitizing their business models and workflows, positioning technology/software as a key driver for long-term efficiency and customer satisfaction, while also broadening their moats and enhancing scalability.

When I first began exploring European pure-play software firms, I wasn't entirely sure where to start or what specific business model attributes to focus on. Anchored by my thesis on the recovery in the European and UK housing, construction, and mortgage broking markets, I targeted software companies with direct exposure to these sectors. I identified two particularly attractive names, and after thorough due diligence - reviewing annual reports, engaging with management, and building valuation models - I developed a clearer understanding.

Notably, software stocks often appear "expensive" when evaluated on a 1-2 year forward multiple basis, a common point of resistance among fellow investors. Some shy away from these stocks, dismissing them as perpetually costly and therefore unlikely to deliver superior returns. I believe this reluctance stems from a discomfort of how to assess these assets properly. Consequently, I find it both intellectually stimulating and strategically vital to develop a framework that can better capture the long-term value potential in this space.

Currently, my investment approach in software is built on three guiding pillars: the private equity discipline exemplified by standout software investors such as Thoma Bravo & Vista Equity; the transformative insights from Peter Thiel's book *Zero to One*; and slightly tweaking the enduring lessons on scale economies shared as articulated by the Nomad Partnership. These principles serve as a framework to distinguish enduring franchises from those likely to falter under competitive pressures.

Applying the strategies of top-tier private market software investors to public market software stocks can help identify undervalued, high-quality companies. Leading private equity firms prioritize mission-critical, high-retention software with strong recurring revenues - principles that also apply to select public market opportunities. In addition, the most compelling firms are technology leaders in their verticals, offer SaaS-based cloud solutions, and maintain control over their customer data.

The AI shift: A new layer of competitive advantage?

We are entering a new phase of software investing; one where artificial intelligence is becoming a competitive differentiator at an unprecedented scale. While AI and machine learning has been used by software companies for decades, the success of models like ChatGPT is not just about technological achievement - it's about the fact that these systems are passing the Turing test, making them viable replacements for human agents. This is not a minor development; it is a fundamental shift in how software is monetized and scaled.

Many firms are now racing to integrate AI into their offerings, but the winners will be those that can embed these capabilities deeply within their core products - turning AI from a feature into an essential, irreplaceable function. This transition will create new moats but also new risks: if everyone can access the same AI models, where does differentiation come from? Our approach is to look for companies that don't just *use* AI but *own* their AI - whether through proprietary datasets, unique infrastructure, or deeply embedded workflows.

Based on my current understanding - after reading hundreds of pages, listening to countless hours of podcasts, and speaking with numerous experts, founders, and managers - it has become clear that the companies best positioned to benefit from the Agentic AI revolution will be those that own their cloud infrastructure, have developed an in-house proprietary data lake, and possess a deep and expansive dataset as well as leverage on it. These factors are crucial for building, marketing, and selling the next generation of AI-driven innovations.

The market's great underestimation: Momentum and long-term thinking

One of the persistent inefficiencies I observe is the market's failure to properly price momentum. Investors often assume that high growth must slow down far earlier than it actually does and that high margins are far less

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ir@hertford.capital. hertford.capital

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sustainable than they appear. As a result, many hesitate to pay a relatively high multiple for a company that has profitably grown at high CAGRs and is expected to continue doing so for the foreseeable future. Instead, they gravitate toward classical value plays, where the prospects seem more straightforward to assess.

Peter Thiel – co-founder of PayPal and Palantir, and an early investor in Airbnb, Facebook, SpaceX, Stripe, Spotify, and Trade Republic, among others – provides an interesting case study. I was surprised to learn that while he participated in Facebook’s Series A, he skipped Series B, only to return for Series C. When asked why he missed out, he explained that at the time, he believed he had already made a great return, and that the valuation seemed a bit too high. Interestingly, he later realized that this wasn’t a one-time mistake.

In the same interview, Thiel noted that through further research, he identified a recurring pattern: the market systematically underestimates the persistence of momentum, particularly in high-growth businesses with enduring characteristics. In his book *Zero to One*, he argues that investors should focus (exclusively) on businesses that either are or have the potential to become monopolies. These businesses often start by dominating a small niche, just as Facebook initially did by becoming the social network for Harvard University.

I found his concept of the *creative monopoly* particularly compelling. Such businesses share their advantages with customers in a dynamic way, using excess earnings to invest in innovation, which in turn enhances customer efficiency and effectiveness. Unlike Nomad Partnership’s *Scale Economies Shared* principle, exemplified by investments like Costco Wholesale, these businesses do not focus on keeping prices as low as possible to ensure durability. Instead, they leverage their pricing power to sustain competitive advantages and long-term growth.

Strong pricing power and a high-margin profile allow these advantaged businesses to take a long-term view, reinvesting excess earnings into new technological innovations. This, in turn, drives high ROI for their customers, deepening product stickiness and ensuring the durability of their own franchise while strengthening their customers’ businesses. Thiel outlines four key characteristics to assess such companies: 1. *Proprietary Technology*, 2. *Network Effects*, 3. *Economies of Scale*, and 4. *Branding*.

Overlooking the holy grail (almost!)

Screening for European software companies is fast and easy, initially generating a rather long list of potential investment candidates. However, the real work begins in refining this list to match the previously mentioned criteria. This process is crucial in narrowing down the selection to companies that truly fit the investment framework. The goal is to identify those with the right characteristics to drive outsized returns for the fund over the long term.

One company that particularly stood out during my research is a relatively small firm located in the Swedish town of Växjö. The company has consistently achieved exceptionally high operating margins in the 70s within its core business and has grown at impressive double-digit organic rates, further accelerating growth through M&A. Its corporate governance is strong, with shareholder alignment reinforced by reasonable compensation structures. Notably, the Chairman also serves as the major shareholder, holding over 18% of the shares.

Initially, I made the same mistake as Peter did with Facebook, ignoring this best-in-class company due to its relatively high revenue multiple. It wasn’t until I made several other investments in the space and took the time to study Peter’s book – learning from his insights and experience – that everything finally clicked. In hindsight, I realize I was essentially sitting in front of the holy grail of software companies in Europe, yet I failed to connect the dots conceptually.

The company I’m referring to is **Fortnox AB**, which offers cloud-based solutions tailored for small and medium-sized enterprises (SMEs). Its core focus lies in accounting, invoicing, and financial management software. Fortnox provides a comprehensive suite of products that enable businesses to streamline their financial operations, including bookkeeping, invoicing, payroll, and other essential administrative functions. For readers in Germany, DATEV is likely a familiar name, while Xero holds a strong presence in the US, UK, Australia, and New Zealand.

Similar to Facebook, Fortnox initially concentrated on a relatively small niche – Swedish SMEs – and has since established a dominant market position, with Visma being its only credible competitor. However, it seems that Fortnox’s product is superior, positioning it as the clear category leader with monopoly-like status within this specific niche. What truly sets Fortnox apart is its relentless focus on customer satisfaction and its continuous innovation, consistently bringing new solutions to the market.

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ir@hertford.capital. hertford.capital

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Leveraging its foundation, Fortnox has expanded its portfolio into broader financial services, seamlessly integrating solutions such as invoicing, payroll, and comprehensive financial management tools. The company also offers Fortnox business cards which work seamlessly as well as small business loans and factoring solutions. This relentless focus on innovation and customer feedback has enabled Fortnox to stay ahead of its competitors, continuously redefining industry standards and cementing its position as a market leader in its niche.

The synergistic effect of robust brand recognition and relentless innovation serves as a powerful internal growth engine. This dynamic not only instils confidence in the company's ability to maintain its strong financial profile but also suggests that it will likely capitalize on further economies of scale over the coming decade. Additionally, there is a compelling opportunity for international expansion into less saturated markets where technological sophistication among competitors may be lower, particularly in Europe and beyond.

Fortnox's strong network effects translate into significant pricing power, a critical factor in sustaining its franchise's durability and resilience. This pricing power enables continuous investment in technological innovations that consistently enhance the user experience. Recently, the company underscored this capability by launching a new suite of packages tailored to its customer base. When compared to more mature players like Xero, there are compelling arguments that Fortnox will further leverage its network effects.

After completing my research, I began exploring the valuation. I felt confident in the durability of the company's competitive advantages, which justified paying a premium multiple for the business. I had a strong conviction that the company could compound at significant rates over the long term. Financially, the business is in excellent shape - with a net cash position, zero debt on the balance sheet, and favourable cash conversion and working capital dynamics.

I extended my typical DCF model - usually spanning a 3-5-year forecast - to a 15-year period to capture the compounding effects more effectively. This longer horizon revealed that the free-cash-flow yield could grow from a modest 2%+ initially to over 15% in the long term, projecting a CAGR (<13%) well below the historical growth rates (>30%). With resilient organic growth rates in the mid-20s, the EBIT multiple for this asset is expected to compress to the low 20s over the medium term, thereby mitigating risk.

Additionally, I believe the asset holds significant upside potential from M&A, also making it an excellent take-out candidate. Remarkably, this scenario unfolded just weeks after I built our position in Fortnox at the low 60s SEK range. EQT, a prominent Swedish private equity firm, along with the Chairman, proposed to take the company private at SEK 90 per share. While it's incredibly rewarding to see my thesis validated, I also firmly believe that the true beneficiaries in this case will be the new owners.

A portfolio of unfair advantages

The ultimate goal is to own a portfolio of businesses that, collectively, possess durable unfair advantages. A portfolio like this gives us an edge over time because the market systematically underestimates the staying power of these firms. While short-term investors rotate based on quarterly guidance, we aim to capture the long arc of compounding that these businesses can deliver. Warren Buffett has often said that the best investments are those where you would be comfortable if the market shut down for ten years.

The same logic applies to software: we want to own businesses that, even with the constant threat of disruption, are still standing strong - and even stronger - a decade from now. I remain committed to this approach - seeking out high-quality, high-ROCE businesses, understanding their moats, and capitalizing on the market's recurring mistake of underestimating momentum. It is a strategy that, over time, I believe will compound wealth in ways that conventional models fail to predict.

Fund update

The fund's name change occurred automatically on March 31st, 2025. No action is required from co-investors. The fund has been renamed from Gehlen Braeutigam Value HI to Hertford Capital, with the change taking effect for all co-investors on April 1st, 2024. I am profoundly grateful for the continued trust and partnership from our long-standing investors and am equally excited to welcome new co-investors. I look forward to strengthening our partnership in the years ahead.

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ir@hertford.capital. hertford.capital

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Sincerely,

Marc
Founder & Managing Director, Hertford Capital GmbH

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<https://www.hansainvest.de/unternehmen/compliance/zusammenfassung-der-anlegerrechte>.

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ir@hertford.capital. hertford.capital

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