Monthly Newsletter - December

Hi there, welcome to our newsletter for December.
To our investors - thank you for investing alongside us for the long term.
In this edition you'll find:

- December performance
- Three stocks depressed for three different reasons

December Performance

Due to compliance, performance data must now be viewed directly from the topsheets.

Please click on the links below.

Wholesale Strategy

Retail Strategy

Three stocks depressed for three different reasons

Our core Blue Oceans Strategy is currently being held back as Appen, Beyond Meat and Zip work through issues involving market perceptions and short-term business environments. Let's take a closer look at each of these three and discuss the underlying issues affecting them and potential disconnect with the market.

Appen

Artificial intelligence (AI) programs are only as good as the data that feeds them. In the first instance, every AI program needs a person to label an object to say what it is. This is an image of a bicycle leaning against a wall, this is an image of a person riding a bicycle. This process is called data annotation and it's what Appen does. It has a workforce of over 1 million people around the globe annotating data. You can imagine the demand for the service if you consider each new AI project requires this service. Company XYZ manufacturers components and wants to integrate AI to improve its quality control. Completed parts moving down a conveyor can be scanned by an AI image recognition program to look for defects at a rapid pace. A person still needs to look over perhaps 100's of images of this part to label what a defect looks like so that the AI program can know this is a perfect component vs this component has a defect.

Appen derives most of its revenues from big tech companies who are under enormous pressure to, for example, monitor content on their platforms. Appen can assist with training data for applications such as this content is offensive, this is not. This content is misleading, this is not. **Covid has temporarily changed the priorities of big tech who have found themselves needing to massively upgrade their chatbot infrastructure**

to handle large demand for digital services from people in lock down. This has resulted in a temporary shift in their spending which has impacted revenues for Appen.

Chatbots can require natural language processing data annotation too and Appen is likely to pick up its share of this work however there is a lag between these projects getting designed, completing scope of works beginning and finally being invoiced when they can appear on Appen's financial statements. There is also likely to be a material decline in the growth rate of Appen's revenues while the spending shift continues, as there is less data annotation work required with chatbots vs image, video and voice recognition projects.

The silver lining is that this situation is temporary. Large scale AI projects will resume when one of two things happen. Big tech builds out its required capacity in chat bots or herd immunity to Covid is reached in The United States. The latter is expected to happen by the latter part of this year but the largest unknown here is how many people will opt in to receive the vaccine with a new survey indicating that approximately 25% of Americans don't want to be vaccinated.

The market has sold down Appen rather vigorously after its trading update on the 9th of December, noting a slowdown in revenue growth rates, with the stock dropping 23% over 6 weeks. Some analysts have raised suspicions that other factors might be at play, that perhaps the drop in revenue growth could be due to an incoming competitor. Our analysis finds no such competitor. But in the end, one may well have reached the same conclusion quickly through a series of accurately placed deductive thoughts.

Deductive reasoning starts with facts and then deduces other facts from those facts to arrive at a conclusion. Let's consider some facts around Appen's earnings release and the natural way competition plays out in business environments.

Fact One - Appen draws revenues from around 90% of the world's largest tech companies.

Fact Two - The drop in revenues experienced by Appen in the third quarter was spread across its entire client base.

Fact Three - All of the 'big-four' tech companies reduced their spending at the same time.

Fact Four - It would be extremely unusual, almost impossible, for a company to win substantial contracts from each major player in a large industry in just three months. It would naturally be a gradual process.

Conclusion - Because each of the 'big-four' tech companies dropped their spending at the same time, in a short period, it's likely they were each affected by the same factor, which could be a competitor or could be covid. **However, it is extremely unlikely that a competitor could take substantial market share across each major player in such a large industry in just three months and very likely that the common reason for reducing spending was covid, just as Appen reported.**

We continue to view Appen as a compelling long-term investment despite a likely dip in revenue growth in the short-term. **By staying invested we are allowing compounding**

to take place.

Beyond Meat

Sales of Beyond Meat products can be broken into two sales channels; **retail** and **food-service**. Retail involves sales to supermarkets and other similar retail outlets, whereas food-service involves the action of preparing and serving Beyond Meat products at restaurants, bars, clubs and cafes. In March 2019 global sales in food service were 73% of retail. **By September 2020 food-service had plummeted to just 35% of retail, as public places were closed due to the pandemic.**

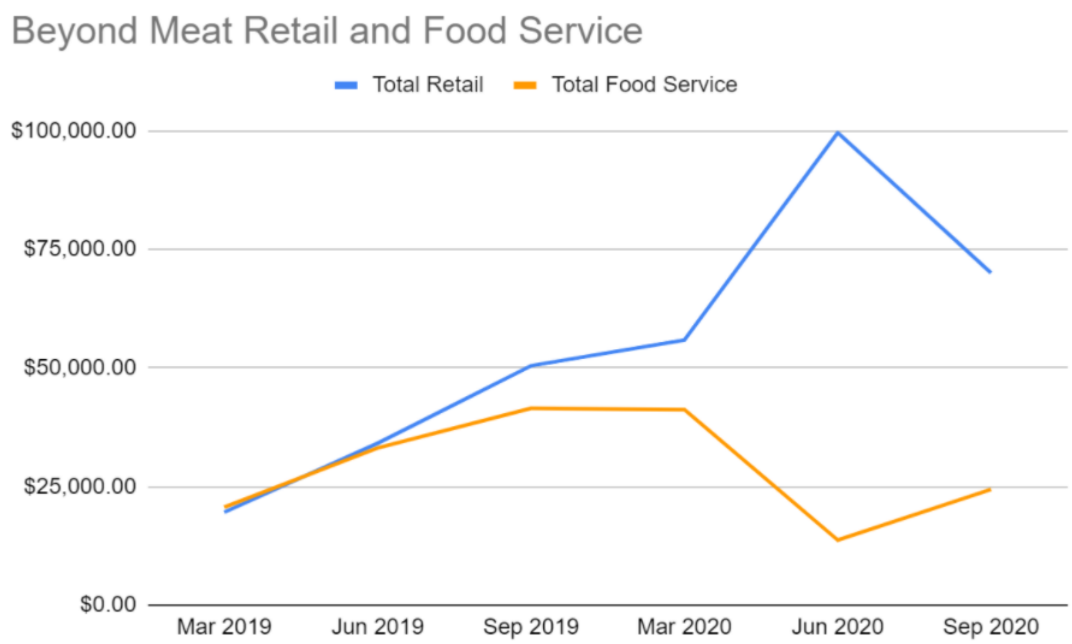

Chart One. Beyond Meat global sales channels in retail and food-service. Source: Beyond Meat.

Chart one above illustrates the sharp decline in food-service, and the subsequent rise in retail, as lockdowns took hold. Retail enjoyed a significant boost in mid 2020 as meat became unavailable due to abattoir closures and consumers stocked their freezers. The lingering issue is that rises in retail are not making up for losses in food service and so long as the pandemic persists. **Beyond's revenue growth is likely to be significantly reduced as compared to before the pandemic with a strong rebound likely post pandemic.**
For us, Beyond Meat is a long-term investment. We're looking past the pandemic. We want to see where the company is in 2-3 years when we expect three things to have happened.

1. Beyond Meat's meat patty will reach or surpass price parity with beef.
2. The meat patty will improve in taste and mouthfeel by 30% or more.
3. Increased volumes due to points 1 and 2 allow for net margin to begin as factories reach optimal capacity and supply chains orientate for the new demand in plant protein.

Zip

I covered the Zip selloff as a stand alone heading in the November newsletter. **As we finalise this newsletter at COB 21/01/21, Zip's stock price is up some 23% today off the back of a strong December update.** This somewhat rectifies the situation, however, I still feel the discounted stock price is unwarranted.

The same factors I outlined in the November newsletter are still holding the stock back now, so I will only recap briefly here. The two main issues holding the valuation back appear to be:

- An unwarranted market view of significant execution risk in UK rollout and recent purchase of two new BNPL providers. Our view is that the UK rollout begins with Zip's existing clients in Australia and the US, who also operate in the UK, and will not result in onerous marketing spend. In regards to the new acquisitions, Zip is a silent partner with these companies and not involved in day to day operations, which is no different to the initial buy-in to Quadpay in the US. **These are strategic plays for regional licencing if and when Zip needs it, and they pose no execution risk as some analysts have been claiming.**
- An unwarranted market view that Zip is most at risk of dropping out of the industry due to being unable to compete with other players. **Zip has proven it can compete strongly in a competitive market and has differentiated itself in a number of ways.** It competes strongly in one of the most mature BNPL regions, Australia, with the full suite of BNPL providers and it will be able to do so in global regions.

Taking Climate Action

After a tumultuous few weeks, Joe Biden has been officially sworn in as President of the USA. We expect a whole raft of new policies and executive orders to come, and central to this will be action on Climate Change. This is an investment opportunity with huge potential, and we're well positioned with the likes of **SolarEdge** in the portfolio.

You can read our **investment-thesis for SolarEdge** HERE

And you can read about the **economic benefits of combating climate change** HERE

All the best
Will Simpson
Portfolio Manager

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