BLUE OCEANS CAPITAL

Monthly Newsletter - November

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

- November performance
- Alfen Purchase
- Zip selloff unwarranted
- The Trade Desk becomes indispensable

November Performance

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

Please click on the links below.

Wholesale Strategy

Retail Strategy

Alfen Purchase

You may recall from the October letter my discussion around the difficulties Europe is facing in regards to the transition to sustainable power and the influx of electric vehicles (EVs) making the scenario more challenging. I mentioned Alfen, a provider of smart grid, EV charging and battery solutions. In November, we made a purchase into this stock out of a small sale of our Trade Desk Holdings that had simultaneously become a high portion of our portfolio, and overvalued. Let me briefly discuss three major narratives that underscore our investment in Alfen.

1. Renewables create grid variability
Europe is leading the global charge to 100% renewable energy. In doing so vast capacity in wind and solar is coming online and those sources are obviously quite variable. Traditional grids were built to handle predominantly hydro, coal and nuclear power. These were predictable sources of power that closely matched output to demand. Infrastructure simply had to deliver that output to where it was consumed. In the age of renewables, the demands of the grid have become vastly more complex. A grid now needs to know what level of output available sources are producing and to be able to rout that output to where the demand is at that particular time. To do this, a grid needs to become "smart," much like when your phone became smart when it was internet connected through hardware and software.

How does the need for smart grids benefit Alfen?
Installing and maintaining smart grids is Alfen's core business. Alfen has:
- Been involved in grid maintenance and upgrades for over 80 years.
- Extensive experience in connecting solar and wind parks to the grid.

- Built its own hardware and software that collects data from various renewable power sources allowing grid operators to manage these flows, anticipate bottlenecks, and to respond to them before outages arise.

2. When batteries cost less than 100$/kWh, EVs reach price parity with the combustion engine

EVs are currently cheaper than comparable combustion engine vehicles when considering the total cost of ownership, however, their upfront costs are higher. When the price of EV batteries falls below 100$/kWh, electric cars will sell for the same price as their combustion engine equivalents. At that point we expect a dramatic increase in the number of EVs sold.

When will that happen?

We expect the price of EV batteries to fall under 100$/kWh in the next 2 years based on the current trend in price reduction and excellerating EV purchases. The trend in cost reduction of battery packs is shown in Chart One below.

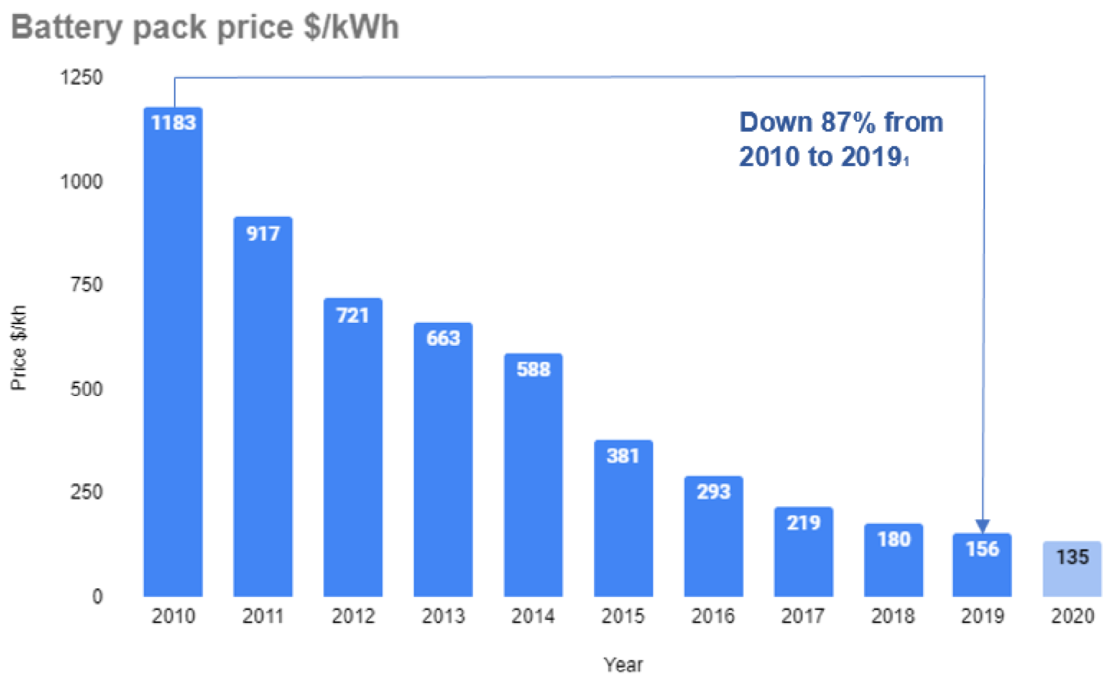

Chart One. Reduction in battery pack price 2010 to 2019.

1. Bloomberg, 2020.

How does the inflection point of EV sales benefit Alfen?

Alfen's second largest revenue stream is in the production, connection and maintenance of EV charging stations. It offers a range of charging solutions for both residential and commercial applications. We expect a rapid uptake of EVs to greatly benefit Alfen, not only through its EV charging business but also through its smart grid and batteries solutions that will see greater demand as EV's draw from the grid.

3. Transfer in mobility power source from oil to electrons will require grid batteries.

Demand charges account for a significant fraction of consumers' electric bills. They can range from $2 per kilowatt to $90 per kilowatt, and can make EV-charging stations unprofitable (McKinsey 2020). On-site battery storage at EV charging stations will save money for customers by not triggering a higher demand charge. Batteries at charging stations will enable charging up the storage system from the grid when demand is low, and using the stored energy to charge EVs when demand is high. For example, when energy demand is high, an EV can be charged from the battery rather than by drawing energy directly from the grid.

How does the need for batteries benefit Alfen?
Indirect benefit- Installing storage systems at charging stations will improve the charging infrastructure significantly. This will further propel demand for EVs, thereby increasing the demand for charging stations. Alfen offers a wide range of modular energy storage systems, both stationary and mobile, and has been picked by several notable companies like Vattenfall, Ionity, Stedin, etc. for the supply of energy storage systems. This has added to the credibility of the company in the Energy storage business. Furthermore, since the company already has established partnerships in the smart grid and charging stations segments, there is a significant opportunity to cross sell the storage systems. For example, the company cross sold to Shell:Alfen had won a contract from Shell to deliver grid connections for its ultrafast EV charging network, and they then secured a project to supply an energy storage system as well. (Alfen 2019; Renewable Energy magazine 2020) In addition to cross selling, the company also has opportunities to offer integrated solutions.

Zip selloff unwarranted

The stock price of Zip has come under pressure in recent weeks with concern around the entrance of PayPal into the BNPL space, and Citi analyst Siraj Ahmed claiming that Zip is most at risk of succumbing to rising competition between global platforms. From our perspective, we are weary of the rapidly changing landscape Zip operates in, but for the time being we are confident in Zip’s future. We are confident because Zip has a strong value proposition relative to its competitors, it continues to compete well in the Australian market, is scaling well internationally, and is moving into higher-margin business lending.

Competitive value proposition
BNPL competitors all offer interest free periods and no establishment fees. Zip is differentiating itself in the market by offering a product with no scheduled repayments, industry-leading low repayment fees, and a robust yet responsible initial credit limit.

Competing strongly in the Australian Market
Some of the biggest players in the Australian market include Afterpay, Klarna, humm, Openpay, Laybuy and Splitit. The fact that Zip competes so strongly against such broad competition should not be overlooked. The two largest players in the Australian market are Afterpay and Zip. Zip’s transaction volume grew faster than Afterpay in the Australian market during the key retail month of November that includes Black Friday sales, growing 60% year on year vs Afterpay at 54%.

Scaling well internationally
Given the intensity of competition in the ANZ market, we see evidence of Zip's ability to compete strongly here as one indication of how it will do internationally. We are happy with the rate of Quadpay’s expansion in the US, albeit off a low base. In regards to the UK, we expect Zip to establish a solid beach-head in the coming year, seeded from the existing

merchant relationships with those retailers currently being served in ANZ and the US that also have operations in the UK. Zip's presence in South Africa is also noteworthy as the only BNPL option in a $67 billion market.

Higher margins from business lending
SMEs have been underserved in business banking by mainstream banks, and often lack access to cost effective, unsecured sources of credit. Zip is well placed to serve this market with 25,000 existing merchants and the digital assets to serve a large scale lending platform. Those factors coupled with loan sizes up to $500,000 will yield high margins for Zip, and we are excited to see how this business unfolds.

The Trade Desk becomes indispensable

The global market for Programmatic Advertising Platform, estimated at US$5.2 Billion in the year 2020, is projected to reach a revised size of US$33.7 Billion by 2027 (Research and Markets 2020). TTD has positioned itself well to be resilient in the face of covid and indispensable to global advertisers for three main reasons:

1. Firstly, uncertain times caused marketers to become more deliberate, data driven and agile in their advertising. The economic pressure due to the Covid situation has prompted companies to look for maximum ROI on their ad spend. Marketers saw value in programmatic advertising as it provides real time reporting and data measurement allowing marketers to track their campaigns and adjust as required.
2. The Covid 19 situation fueled a rapid consumer shift from cable subscriptions to other advanced alternatives including CTV, streaming platforms, etc. For example, surveys conducted by research agencies on the behalf of TTD revealed that the percentage of people planning to cancel cable subscription due to Covid in Australia was 14%, while in the USA it was 11% (Business Wire 2020). Firstly, cable TV relied on the telecast of sporting events that is not happening currently. Furthermore, Covid has impacted households economically and cable TV is being perceived to be relatively expensive. Cable companies too are facing economic pressures and are forced to put more ads in front of consumers thereby creating a worse user experience. The accelerated consumer shift from cable to CTV has further motivated marketers to invest in programmatic advertising.
3. Furthermore, TTD is considered an alternative to the 'walled garden' adtech companies such as Google and Facebook. This means that brands using TTD have more control over data, and a relatively better picture of how their ads are performing. Secondly,TTD helps brands to shift from user generated content (UGC) to premium TV content. UGC is unmonitored, may be divisive, controversial or fake. Many brands are, therefore, particularly averse to placing their ads next to UGC. In fact, TTD won tens of millions of dollars of spend from UGC platforms in Q3 (TTD Q3 2020 earnings call 2020).

Covid forced marketers to rethink their advertising strategies leading to a surge in programmatic advertising. However, programmatic advertising is expected to continue growing in the post-COVID world as well. This is because of the omnichannel advertising approach of programmatic advertising. Consumers' switch from cable subscriptions to connected TVs will continue to accelerate in the future. As more and more people/households spend more time on channels like the desktop, smartphones, and connected TVs etc., programmatic advertising will provide businesses with the opportunity to reach their audience in a more efficient and effective way across those channels

Finally, as my last letter of 2020, I would like to wish each of our fellow investors and readers a safe and enjoyable holiday period. I'm looking forward to what should hopefully be a more normal 2021.

All the best
Will Simpson
Portfolio Manager