



## Monthly Newsletter - June

Hi there,

To our investors - thank you for investing alongside us, for the long term.

In this edition you'll find:

- June performance
- I was probably wrong about Appen
- Two new opportunities from IPOs
- Improvement in our IPO scanning framework
- Our investment case for dLocal

### June Performance

Please find performance data by clicking on the links below.

[Wholesale Strategy](#)

[Retail Strategy](#)

First of all, my apologies for a quite delayed newsletter this month. Some essential analysis had to be prioritised for all our benefit however I should have found a way to get this note out to you sooner.

### I was probably wrong about Appen

In the [December](#) newsletter I strongly stated that the market was wrong and I was right about Appen. The central issue being around changes in Appen's largest clients either temporarily adapting to Covid or structurally changing their business models in a way that would materially affect Appen's business. My hard line was the former however it seems apparent that there is materiality in the latter. Appen maintains its revenue guidance for this year however in recent updates management has acknowledged some changes in their client's usage of their services that is more material than my December note acknowledged.

The fallout from any change in Appen's largest clients won't really be known for another 12 months or more. What we have recognised is that there is an element of irreducibility in Appen's business model where it becomes very difficult to predict the demand for data annotation by big tech and the potential for largely manual data annotation, as is the majority of Appen's revenue, to be automated or parts thereof. Fortunately, two outstanding opportunities presented with compelling fundamentals, much stronger than our base case for Appen, and we were comfortable in selling this position and upgrading the capital into those investments. Note that I first purchased Appen in August 2017.

## **Two new opportunities from IPOs**

Our investment strategy involves scanning global indexes every three months and conducting IPO searches every month. We look at every exchange except for emerging markets and those where annual reports are likely to be in foreign languages. We have an internal database of over 8000 companies we have reviewed and will not invest in due to factors intrinsic to those business models. This approach means we have thoroughly covered all listed stocks with new opportunities in that basket arising from attractive valuation entry points.

What's occurring now, from many cycles of the above process, is that new opportunities are naturally arising from IPOs. A flood of IPOs have recently poured onto global markets (frustratingly many of them SPACs) from built up demand where companies chose not to list last year. This situation threw up two compelling opportunities for us, dLocal and Doximity. Please see below our investment case for dLocal. We will cover [Doximity](#), a medical professional network platform, in next month's newsletter.

Positions were funded out of a mixture of cash made available from the sale of Beyond Meat and Appen as well as a portion of SolarEdge that was overweighted in the portfolio. Both positions were opened at around 8% of the portfolio as we are targeting a 12 stock portfolio subject to availability of attractive investments.

## **Improvement in our IPO scanning framework**

As mentioned above, our method for covering IPOs was to scan relevant global markets every month for stocks that had listed over the prior month. This proved to be a significant problem with dLocal and Doximity. Those companies were listed as upcoming IPOs on the NASDAQ a full month or more before we first became aware of them. That fact has come at a significant cost to you and I. Had we been aware of them before listing we would have had ample time to complete analysis and valuation and been ready to make purchases during their first trading sessions. The value of both companies was significantly lower during that time than when we had completed analysis and were ready to make purchases using our post IPO scanning method as described above.

We immediately moved to rectify the problem. We are now scanning global markets for upcoming IPOs every two weeks or less. In most instances, this will give us ample time to complete analysis before companies list. We will know our valuation before the company is trading in the market and as soon as it does, we'll be ready to make a purchase should the market price be fair or discounted.

## **Our investment case for dLocal**

By giving people access to payments services, often for the first time, DLocal is helping millions to gain access to vital digital services that can be life-changing.

Access to digital services is associated with significant reductions in poverty and food insecurity arising from its ability to advance education, gender equality and access to economic opportunities.<sup>3 19 21</sup> People in less-developed markets are crying out for digital services that many in the rest of the world take for granted. Individuals want access to basic email and search services, online education and entertainment. Businesses need access to online management tools, inventory and professional services. However, people

in whole regions are often locked out of these services due to not having a bank account, not being able to pay in the merchant's currency<sup>1 2</sup> or the service they require not being available in their area.

dLocal is a payments service platform that exists to solve each of these problems. It connects people in emerging markets with global digital services even if they don't have a bank account and with their own currency. It takes care of all FX transfers, local compliance and chargebacks, allowing merchants access to regions that were previously out of reach.

**It's enabling disadvantaged people across the world to access digital services, giving them the tools they need to bridge the digital divide and improve their standard of living<sup>3</sup>.**

Through one single integration, digital merchants can access 29 countries and seamlessly make and receive payments. All compliance, FX transfers, tax, refunds and fraud risk is taken care of. dLocal does this by having teams on the ground in each country whose job it is to stay abreast of local laws and payment preferences. By getting these things right, dLocal gives merchants an extremely valuable tool - seamless access to 100's of millions of potential new clients at low cost and low risk. Their clients include global tech companies such as Microsoft, Amazon, Uber, Wix, Wikimedia, Mailchimp, and Uber.

#### **High revenue growth and return on invested capital**

Solving a complex problem with high frequency by using code allows for high growth with strong margins. dLocal is currently growing at over 100% per annum with a return on invested capital over 20%.

#### **dLocal Quarterly Revenue March 2019 to March 2021**

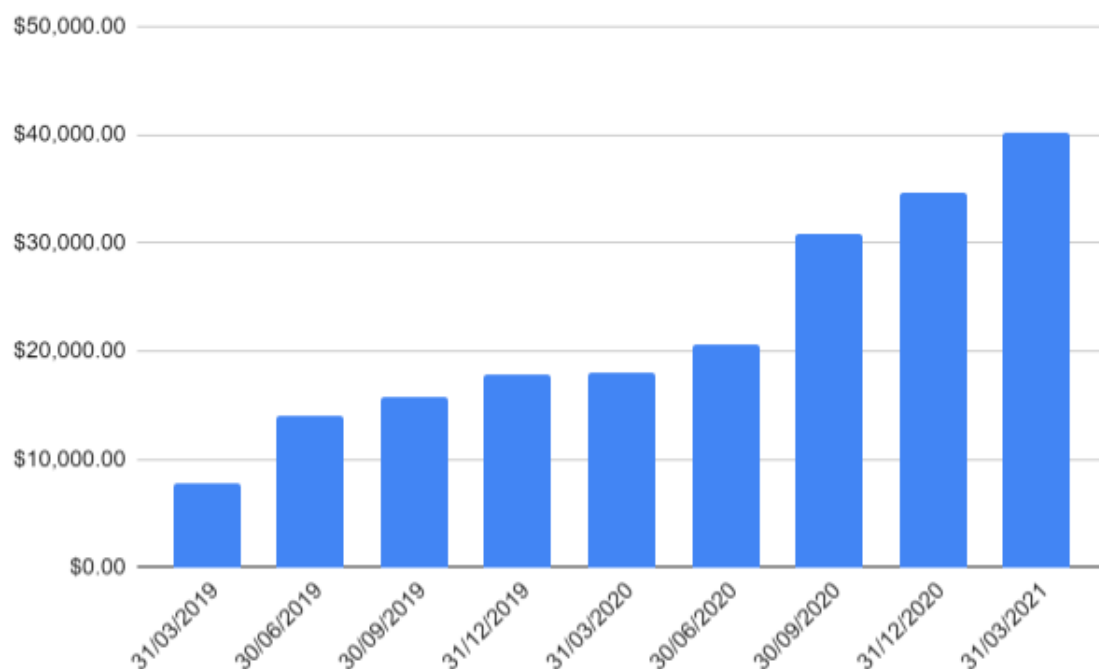


Chart One. dLocal quarterly growth in revenues from March 2019 to March 2020. Source: dLocal IPO Prospectus.

Management has grown the company through investor funds and internally generated cash flows and so the company has no debt and adequate cash on hand to cover working capital requirements, platform development, and acquisitions. Cash flows from operations in 2020 were over \$24m USD and are enough to cover working capital requirements and product development. A strong, self-funded balance sheet with fast growing revenues and high return on invested capital maximises the opportunity for shareholder value creation. How does dLocal achieve such rapid growth and can it be sustained?

### Major revenue growth drivers

#### Established in the fastest growing geographies

dLocal operates in the fastest growing economies for both growth in the number of electronic transactions and revenues from electronic transactions. Data from the International Monetary Fund (IMF) showed that in 2019 emerging markets represented 57% of global aggregate GDP having risen from 43% in 2000. Electronic payments, in selected markets dLocal operates in, are growing even faster. Figure 1 below shows the growth rate of electronic payments on the X axis and growth in payments revenue on the Y axis. dLocal is operational in most of the fastest growing markets including India, Nigeria, Argentina, Peru, Thailand, South Africa, Columbia, Brazil and Mexico.

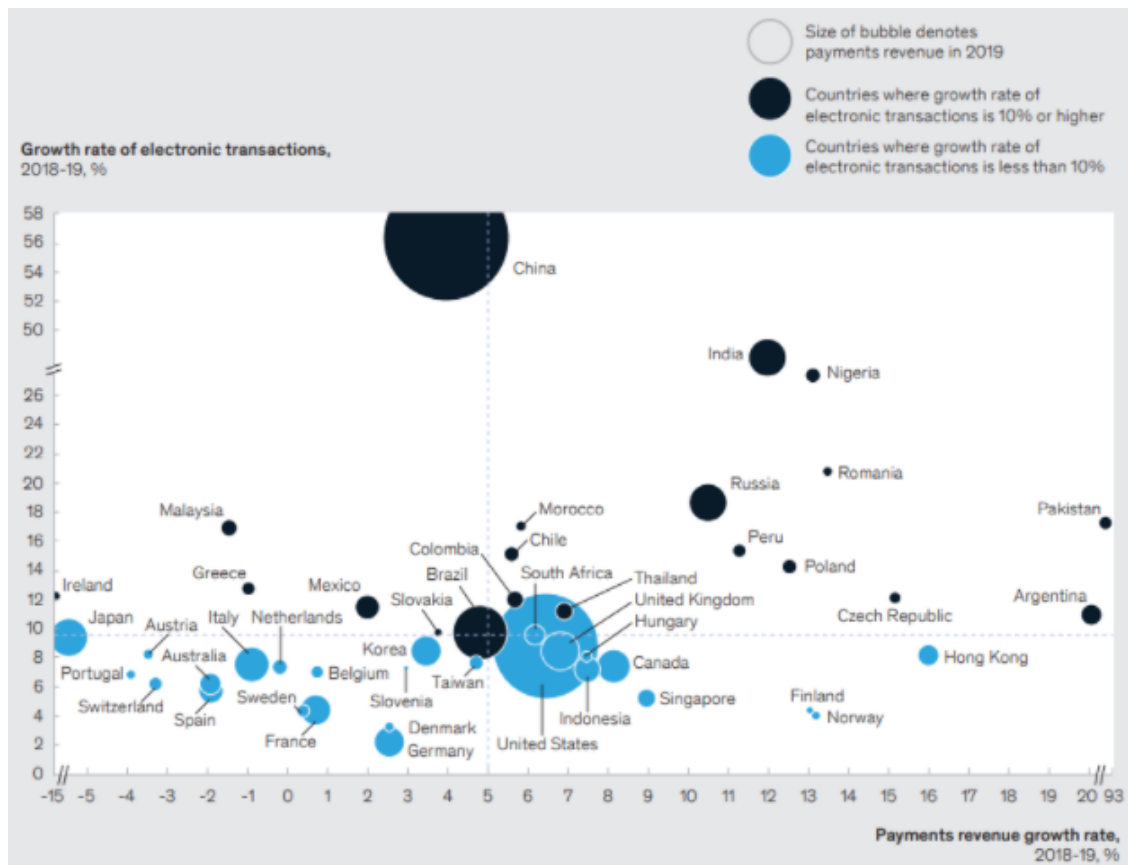


Figure 1. Growth rate in electronic payment transactions and revenue<sup>4</sup>.

#### Transition to digital accelerated by Covid-19

The impacts of Covid-19 have been felt the world over with individuals accelerating their shift towards e-commerce, digital payments, instant payments and cash alternatives. Businesses have been forced to adapt at an unprecedented rate upgrading cashless payment facilities and online availability demanded by their customers.<sup>6</sup> Banks in multiple geographies are closing branches and ATMs which in many cases wont open again while

Amazon, eBay, Flipcart and Shopify have seen seller sign ups increase 70 - 150% since the start of the pandemic.<sup>5</sup>

While some degree of reversion to previous behaviours can be expected for some of these changes the expectation is that, for the main part, new habits will stick. People, generally, are preferring digital payments methods and digital access to goods and services and will continue using those services after the pandemic<sup>5</sup>.

### **Nearly half the world's population is still not connected to the internet**

There are currently 3.6 billion people in emerging markets that aren't connected to the internet. Why? Cost is an issue for some, but for most it's the quality of the connection that's the problem, with a lack of infrastructure meaning the connection is too slow to work or options to connect simply don't exist<sup>6</sup>. In just a few weeks those problems might be resolved which could see 100's of thousands of people coming online and consuming digital services for the first time. Elon Musk's Starlink satellite network has capabilities of beaming high-speed internet to every location around the world, except polar regions. It is currently operational in 12 countries<sup>7</sup> and is expected to cover every part of the globe excluding polar regions as soon as August<sup>8</sup>. With a high-speed internet connection available to any of 3.6 billion people who want to use it, the addressable market for digital services in emerging markets could grow significantly. This will strengthen the market entry case for global merchants who will need to partner with a payment service provider like dLocal to do business in these regions.

### **Growing complexity in the payments ecosystem**

Doing business in emerging markets has traditionally not been easy. Ongoing changes in payments regulations, infrastructure, payment methods, fraud protection requirements and tax obligations makes for substantial complexity. There are over 600 different ways to pay across Africa, Asia, and Latin America. Each country has their own preference of payment method across cash, cards, or digital means and each has their own unique mix of digital transfers often only available in that country. However with the complexity and variation of payment methods, constantly changing compliance regulations, FX transfers and fraud risk, international companies have been understandably reluctant to enter these markets.

Each country is working to make their digital ecosystems safer, faster and easier to use. For example Brazil's new payment infrastructure PIX allows for instant transfers between digital wallets radically changing the payment ecosystem and the central Bank of Chile has completed a new regulatory framework to move towards international standards<sup>9</sup>.

Commerce both into and between emerging markets is held back to a large extent by lack of clear digital regulation policy and adequate consumer protection. In many instances, large online sellers such as Amazon and Ebay are providing these assurances where local policies don't exist and are often better than national policies where those do exist. dLocal is enabling marketplaces in regions they could not exist in before and by doing so they are raising the standards of e-commerce governance that gives consumers in those regions confidence to transact online opening up immense opportunities that were not previously available.

Alternative Payment Methods, or APMs, are growing at an unprecedented pace accelerated by evolving regulation, innovation and interest from retailers<sup>10</sup>. In Latin America digital wallets experienced the largest growth of any region in 2020 growing 43.5% over the year with strong growth expected to continue.<sup>10</sup> Customers' preference for paying by a multitude of preferred APMs demands merchants operate payment gateways that can accept a wide array of different payment methods.

The rapid shift to digital has made for a far greater demand in enhanced authorisation and fraud detection, and chargeback capability. Each country also has its own laws regarding tax obligations and these are also frequently changing<sup>11</sup>.

Income tax collection from e-commerce is recognised as a major issue in emerging markets. dLocal is actively assisting governments in regional jurisdictions to collect their fair share of tax revenue directly contributing to those countries' economies.

It's not feasible for any merchant to handle this rate of change and complexity in-house. They must partner with a payment service provider that specialises in knowing each country's payment environment, and that can ensure they remain current and compliant. dLocal makes doing business in emerging markets easy.

## **Expansion of merchant revenues in four ways**

### **1. Growth of existing merchants in existing markets**

Existing merchants are rapidly expanding in markets in which they already have an established presence. For example, Latin America has been Uber's fastest growing region globally<sup>12</sup> despite having established itself in the area since 2013<sup>13</sup>. Amazon is also rapidly growing in the region with a representative of the company stating in September 2020, "Brazil is the country with the fastest growth in Amazon Prime subscriptions."<sup>14</sup>

### **1. Onboarding new merchants**

Strong growth comes from the onboarding of new merchants. dLocal has grown from 190 merchants in 2019, to over 330 as of June 2021, and it's growing. Digital companies in developed markets are increasingly chasing growth in emerging markets where their services are highly sought after. This demand, coupled with dLocal making entry into those markets affordable, simple, compliant, and risk-free, will see significant growth in new merchants added to the platform.

### **1. Expanding into new regions**

In 2019 dLocal had operations in 11 emerging markets, and that rose to 29 in 2020. Their strategy is to continue opening up new markets with the goal of eventually being operational in all relevant emerging markets. New regions are currently being opened up in Africa with the recent addition of Egypt and South Africa and also Asia with recent expansion in Indonesia.

### **1. Offering new services**

dLocal is embedded in its clients systems and moves quickly to solve client problems as they occur. It was this dynamic that led to the addition of their pay-out service that arose as a problem for one merchant during the Olympic Games in Rio de Janeiro in 2016. Recently the company has developed card issuing as a service to meet a growing demand for a branded card experience. This will give merchants the ability to issue prepaid cards to their end users. We've seen this line of business to have high margins in numerous other businesses we have analysed.

## **Is it Sustainable?**

Access to e-commerce and mobile money acts as a strong force for poverty reduction through advancing education, providing greater access to economic opportunities and associated promotion of gender equality through both these means.

### Education

dLocal is improving levels of education in emerging markets by enabling access to educational resources through many of its merchant clients. For example, numerous studies have highlighted the significant educational potential of YouTube<sup>15</sup>. Netflix improves education through its documentaries that have been shown to be beneficial in classroom settings<sup>16</sup>, and Facebook has been shown to increase awareness of health topics<sup>17</sup> and as an aid to the delivery of university materials<sup>18</sup>. Digital access to educational resources also improves gender equality in bypassing traditional cultural and mobility barriers, particularly for women in emerging economies<sup>19</sup>.

### Access to economic opportunities

Digitally available products and services offer access to opportunities unencumbered by locality, seasonal variability or political situation. Research by the World Bank has found that at the current pace of economic and social advancement, many of Africa's youth will miss out on reaching their potential and that digital technologies can intercept this trajectory allowing innovation, access to jobs and rapid economic growth<sup>20</sup>.

One of the greatest examples of digital services' ability to improve the lives of the disadvantaged has been in China where e-commerce has created employment opportunities for semi-skilled workers and allowed for more flexible entrepreneurship, particularly in rural areas<sup>21</sup>. E-commerce has also been shown to advance gender equality in China through business opportunities. The ratio of female entrepreneurs to males in e-commerce is almost 1:1 vs 1:3 in traditional businesses. They also tend to be younger with the average female age 31 vs 48 in traditional businesses<sup>22</sup>.

### Valuation and Entry Points

We became aware of dLocal through our June IPO screening. Our valuation indicated a conservative fair price at around \$50 per share with the market price around \$32 to \$35 at that time. We entered positions in the stock at \$38.60 on 21/06/2021 and \$51.49 on 28/06/2021 as shown in Chart Two below (Factset).

**dLocal Stock Price and Entry Points**

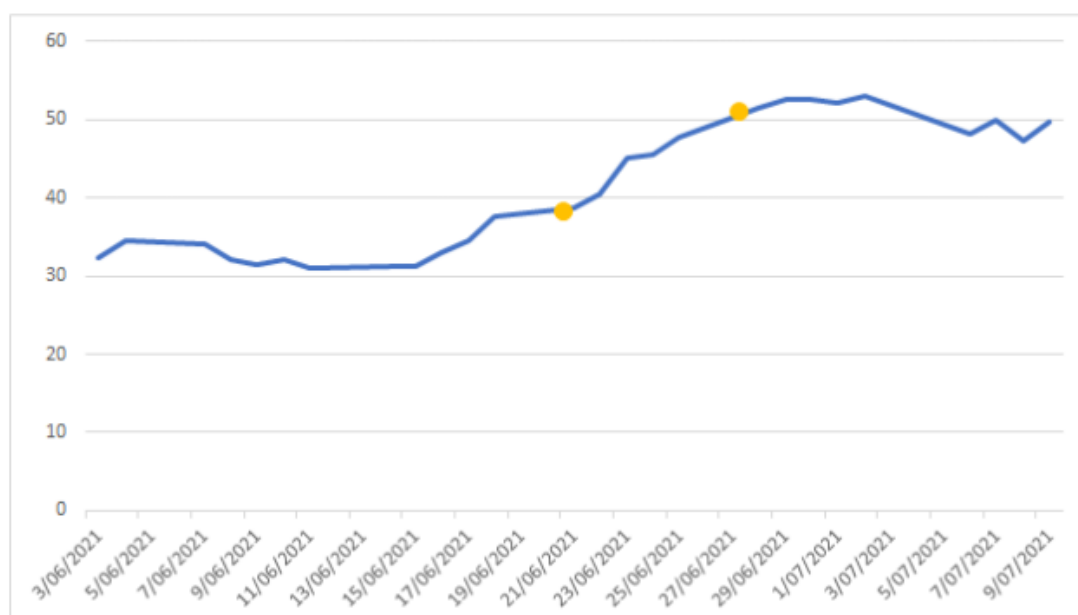


Chart Two. dLocal stock price from IPO and entry points on the 21/06/2021 and the 28/06/2021.

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All the best

**Will Simpson**

**Portfolio Manager**





Blue Oceans Capital, 200 Adelaide St, Brisbane, QLD, 1300 910 445

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