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May 2022 Newsletter

- Savage market selloff while company fundamentals perform well
- Upstart savage market selloff
- Sale of Paypal and purchase of Nu Bank
- Opportunity for rebalancing

Dear fellow investors,

The extreme sell off in the market generally persists with particular rotation out of growth and tech stocks both of which form the basis for much of our portfolio. Our portfolio now stands at around a 35% discount to our most conservative valuations. Market sentiment is at extreme lows with radical price movements being driven by fear and panic, not reason.

At times like this it pays to remain focussed on company fundamentals. And in this regard our portfolio continues to perform quite well. Notable results from this earnings season includes significant revenue growth from dLocal up 117%, Solaredge up 62%, Alfen up 77% and recent addition Nu Bank up 226% year on year. No company in our portfolio has grown revenue less than 30% as detailed below and all are producing strong cash flows from operations.

Companies in our portfolio are excelling while their valuations retreat. Given time, their stock prices will revert to their intrinsic values that has grown significantly during this market downturn.

Upstart savaged in market selloff

The stock price of our recent purchase Upstart has significantly declined due to what we believe to be market misinterpretation and fear. A strong selloff occurred after the company marginally downgraded its earnings outlook to more conservatively factor in inflation impact on loan demand and it reported a small number of loans on its balance sheet but in-line with historical norms. We believe the market has overreacted and see no evidence that suggests an existential threat to Upstart as the stock price movement suggests. We continue to see Upstart as a compelling investment opportunity. See detailed notes below.

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Sale of Paypal

Paypal's business fundamentals continue to remain strong. It has a strong balance sheet, and continues to be profitable and cash flow positive. However, it faces rising competition in the digital payments space from big players such as Amazon, Shopify, Adyen and Stripe.

In April, we were presented with a superior investment opportunity in the form of Nu Bank (NU). In essence, Nu Bank has a large addressable market and dominates its space while growing at over 100% per annum compared to Paypal that is saturated in its market and growing at <20% per annum. See further details below

Opportunity to rebalance the portfolio

The savage selloff in quality technology companies has presented an opportunity for us to rebalance the portfolio into companies where we see a compelling investment case.

We have trimmed our overweight positions in The Trade Desk and SolarEdge taking advantage of heavily discounted Nu Bank by adding further to our position.

All of our companies except for Adyen, which reports semi-annually, have now reported their March quarter results. Each has produced very strong results and we are delighted to share with you those results below.

For performance of the portfolio please click here.

Company Updates

The Trade Desk

Cash position: $1.1 billion including short term investments
Long-term debt: NIL

The Trade Desk is a self-service, cloud-based platform, through which ad buyers can create, manage and optimise more expressive data-driven digital advertising campaigns across ad formats and channels, including display, video, audio, native and social, on a multitude of devices, such as computers, mobile devices and connected TV.
When marketers become more deliberate with spend and look for more efficient investment opportunities, The Trade Desk steps in to maximise returns on their advertising dollar.

The Trade Desk's revenue growth this quarter was its fastest first quarter growth in the last four years. They benefited from a digital advertising environment that's leaning increasingly towards data-driven advertising and measurable results.

Revenue for the first quarter was $315 million, up $95 million and 43% over the same period last year. The net loss for the quarter was $15 million, 165% lower than the Net Profit of $23 million reported in the first quarter last year. The Net Loss was mainly due to an increase in Stock-Based Compensation to $124.9 million, up from $52.4 million in the corresponding period last year. Included in the stock-based compensation was the CEO Performance Option of $66 million, recorded as a component of general and administrative expense (see chart one below).

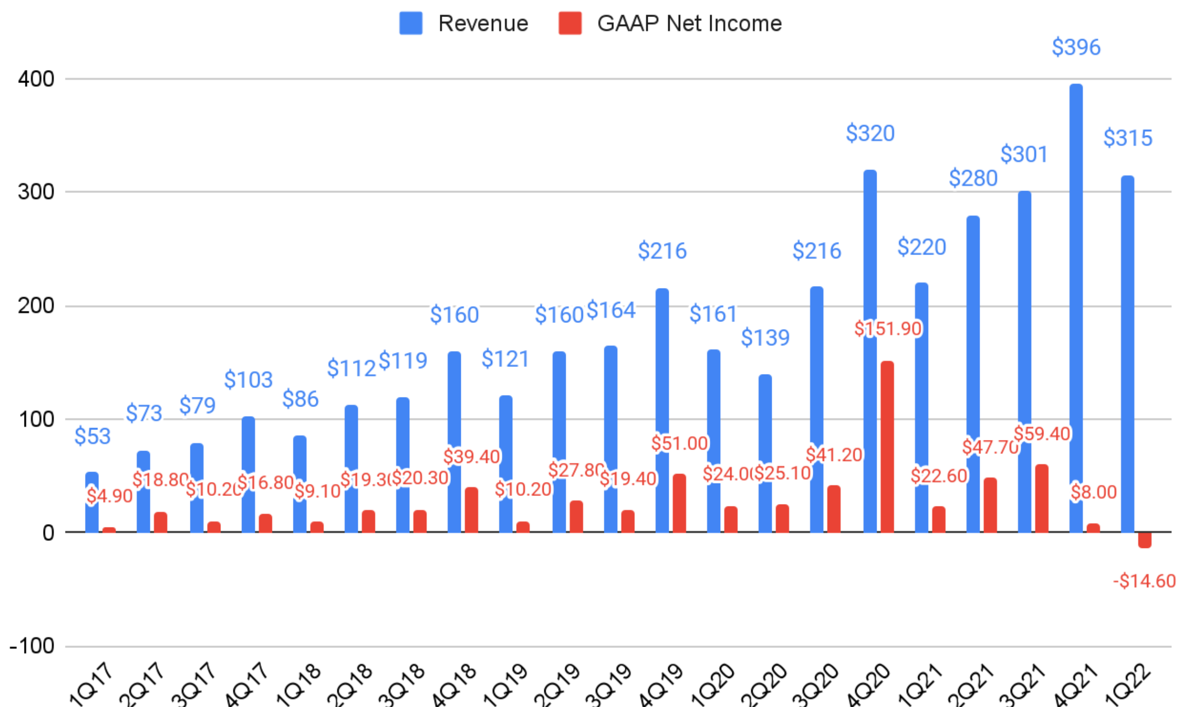

Chart One. The Trade Desk's quarterly revenue and GAAP net income from 2017 to 2021.[1]

As at March 31, 2022 TTD had unrecognised stock-based compensation related to the CEO Performance Option of $596 million, which assuming no acceleration of vesting, is expected to be recognised over a weighted-average period of 2.5 years. This will continue to have an adverse impact on the company's GAAP earnings for the next three fiscal years.

[1] Trade Desk quarterly reports.

The adjusted EBITDA was $121 million or about 38% of revenue, up 72% year on year. In this quarter, they continued to benefit from temporarily lower than expected operating expenses, partly driven by the virtual environment.

As TTD continues to invest in platform operations and technology and development to enhance their product, including programmatic buying of CTV ad inventory, and in sales and marketing to acquire new clients and reinforce relationships with existing clients, we can expect operating expenses to continue increasing significantly in the foreseeable future. Though this may impact profitability negatively in the near term, these investments will contribute to their long-term growth.

Netflix recently announced that they are likely to make ads a part of their future. Some other OTT platforms with plans to implement ad experience are Disney+ and HBO Max. This shift will push content owners all over the world to adapt and require them to embrace biddable environments, moving away from legacy systems and traditional advertising channels such as cable TV.

The internet is being upgraded - from opt-out internet to an opt-in internet - with many different opt-in IDs being created. Some of the IDs will scale and survive, while others won't. Those that scale will be the ones that upgrade the experience for consumers. These will be distributed, encrypted and interoperable.

Trade Desk's new trading platform Solimar, that helps marketers optimise their digital advertising campaigns across the internet, continues to gain traction with an adoption rate already above 80% among their clients. This is expected to reach full adoption by the end of the year. For a platform that was launched only in August last year, this rate of adoption is phenomenal. Solimar helps leverage more data elements to improve margins and Return on Investment (ROI) for customers and in turn helps The Trade Desk spin their business flywheel faster.

The Trade Desk has recently upgraded the Solimar platform. Based on that, along with other drivers such as the upcoming US midterm elections, CTV tailwinds, their international business and the retail media opportunity, we expect continued and accelerating momentum, which in turn will lead to significant long-term growth.

SolarEdge

Cash on hand: $1.16 billion including Current Marketable Securities
Long-term debt: $622.3 million (Convertible Senior Notes)

SolarEdge designs and sells solar energy systems for use in residential and commercial properties, as well as, non-solar products in North America, Europe and other international markets. The Company's solar energy system products include power optimisers, photovoltaic inverters, a Web portal for module-level monitoring and fault detection, battery back-up and solar based EV chargers. The non-solar segment comprises e-mobility, energy storage and UPS products.

Solaredge announced record quarterly revenues of $655.1 million in Q1 FY22, a year-on-year increase of 62% from $405.5 million in Q1 FY21, and an increase of 19% quarter-on-quarter from 551.9 million in Q4 FY21. Net income of $33.1 million in Q1 FY22, an increase of 10% from $30.1 million in Q1 FY21. Growth in revenue from the solar segment was in-line with total revenue, increasing 62% year-on-year and 21% quarter-on-quarter to $608 million. Revenue from the Non-Solar segment followed a similar trend, increasing 62% YoY and slightly decreased from $49.2 million to $47.1 million on a quarter-on-quarter basis (see chart two below).

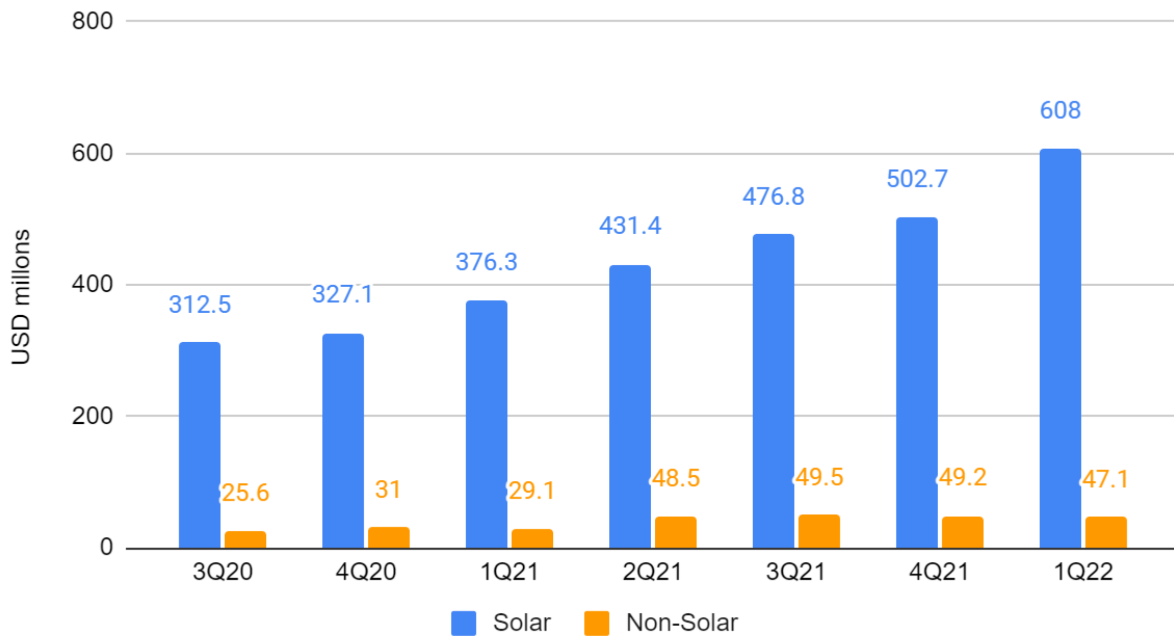

Chart Two. Solaredge's quarterly revenue by segments from Q3 2020 to Q1 2022[2]

Solaredge shipped 5.7 million power optimizers and 211 thousand inverters in 1QFY22, an increase of approx. 54% and 16% respectively YoY (1Q21), and approx. 12% and 4.5%

[2] Solaredge Quarterly reports

respectively over pre-pandemic levels (1QFY20). (see charts three and four below).

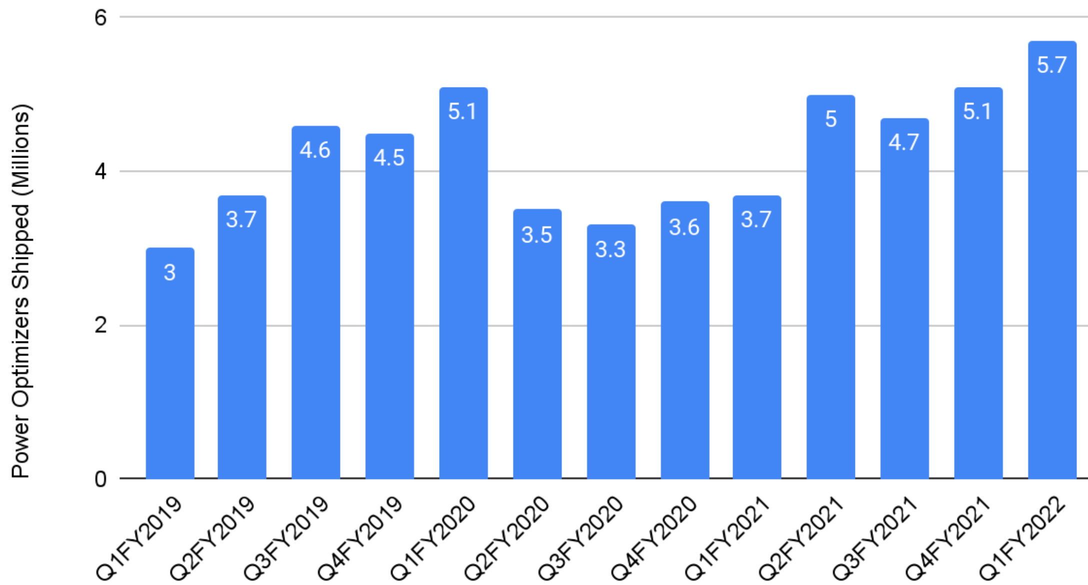

Chart Three. Solaredge Power Optimizers shipments from Q1FY19 to Q1FY22.[3]

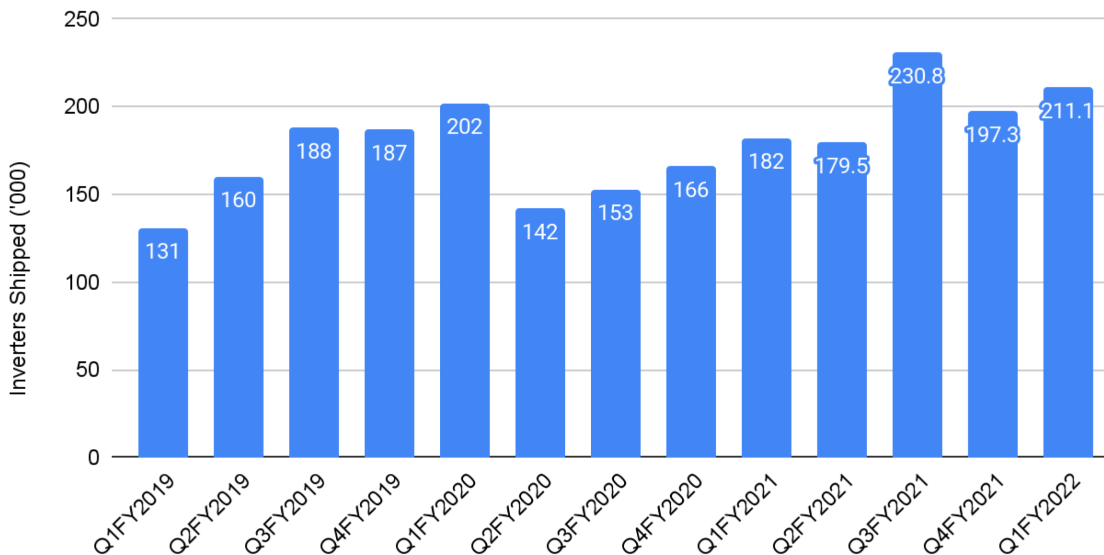

Chart Four. Solaredge Inverters shipments from Q1FY19 to Q1FY22.[4]

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[3] Solaredge Quarterly reports
[4] Solaredge Quarterly reports

Gross margins have continued to erode over the last few quarters, primarily due to the following factors:

- The devaluation of the euro against the US dollar has significantly impacted margins due to a major portion of sales being generated in Europe. This is expected to continue and negatively impact margins in the second quarter as well.
- Batteries have a lower gross margin compared to the other products. The increased portion of sales from batteries has led to lower overall gross margins.
- Costs paid to contract manufacturers in order to continue manufacturing during the Chinese New Year period have led to higher overall costs of revenues. These costs are one-time in nature. There were also ramp-up expenses in Mexico, China and Vietnam, which are expected to continue till the end of the year.
- The company is facing some operational challenges in the supply chain while ramping up production to meet the continuously increasing demand for inverters, optimizers and batteries. The first challenge is the electronic component availability, particularly at higher volumes required. The second is unanticipated disruptions due to the pandemic, such as the recent situation in Shanghai adversely affecting the supply of raw materials and components. Third, longer logistic routes are affecting both the supply chain to the manufacturing sites as well as the shipments to end consumers. The company has had to compensate for these challenges by expediting shipments and paying higher logistics costs. This has led to them raising prices in order to cover some of the increased components and material costs.

They expect to mitigate these higher costs as the manufacturing capabilities ramp up, especially in the Mexico facility, which is on track to supply the entire residential inverter and optimizer segment in the US by year-end.

The company has given revenue guidance of $710 million to $740 million for Q2 FY2022, with gross margin within the range of 26% to 29%. Gross margin for the inverter and optimizer product lines is expected to return back up to the range of 35% to 37% in the second half of FY22. The lower margins of the commercial, e-mobility and battery segments will continue to impact overall gross margins of the company but with the expected decrease in expedited shipping costs and lower reliance on the manufacturing unit in China, there should be an uptick in margins overall, which will lead to higher ROIC to go along with the expected top line growth.

Adyen

Cash: €4.6 billion
Long-term debt: NIL

As mentioned above, Adyen reports semi-annually so there is no March quarter update. We expect results to be out on August 18th and will update you on the company's performance in our next quarterly newsletter.

Upstart

Cash position: $ 757.8 million
Long-term debt:$ 769.2 million

Upstart has created the industry's most sophisticated automatic lending platform. The result is much higher approval rates with less risk. It's saving people money while making financial institutions more profitable.

Upstart reported impressive Q1 2022 performance. Its total revenue in the quarter was $310 million, an increase of 156% from the first quarter of 2021. Net income in the quarter was $32.7 million, an year-on-year increase of 224%. However, the firm’s share price sharply crashed due to a gap between the company’s outlook and market expectations. Upstart shares, as of the time of writing, are $40.47 down 73% since our purchase. This panic- stricken over-reaction has overshadowed the business fundamentals of the company, which continue to remain unchanged and strong.

Factors that have caused the stock price to nose-dive -

1. Upstart held 604.4 million worth of loans and residuals on its balance sheet, as of March 31, 2022 up from $261 million in the fourth quarter of 2021. The market has apparently viewed this as the company’s reduced ability to attract funding from banks and institutional investors. There are also concerns regarding the company’s increased credit risk exposure due to these loans on the balance sheet.

   Our take on this- The company reports that three-quarters of the loans (about $450m out of $604.4m) are R&D loans related to auto refi business, and the management expects to sell them once initial testing is complete. However, these loans may be replaced by new loans for testing new products that the company plans to launch. Using their own balance sheet to test new products is not a new development for Upstart. As a percentage of transaction volume, R&D related loans have been varying (see chart five). In the quarter ending Sep 2020, Upstart’s balance sheet loans as a percentage of transaction volume in the period was 15.8%. This was the period in which the company had started to offer auto loans on its platform for the first time. In fact, any time Upstart enters a new lending category it requires much data to test its models to accurately forecast the likely performance of new products before those products can be commercialised to institutional investors. This is how AI models work. R&D loans funded by the balance sheet have been an inherent part of Upstart’s new products development and a rise in these loans doesn’t appear concerning at these levels.

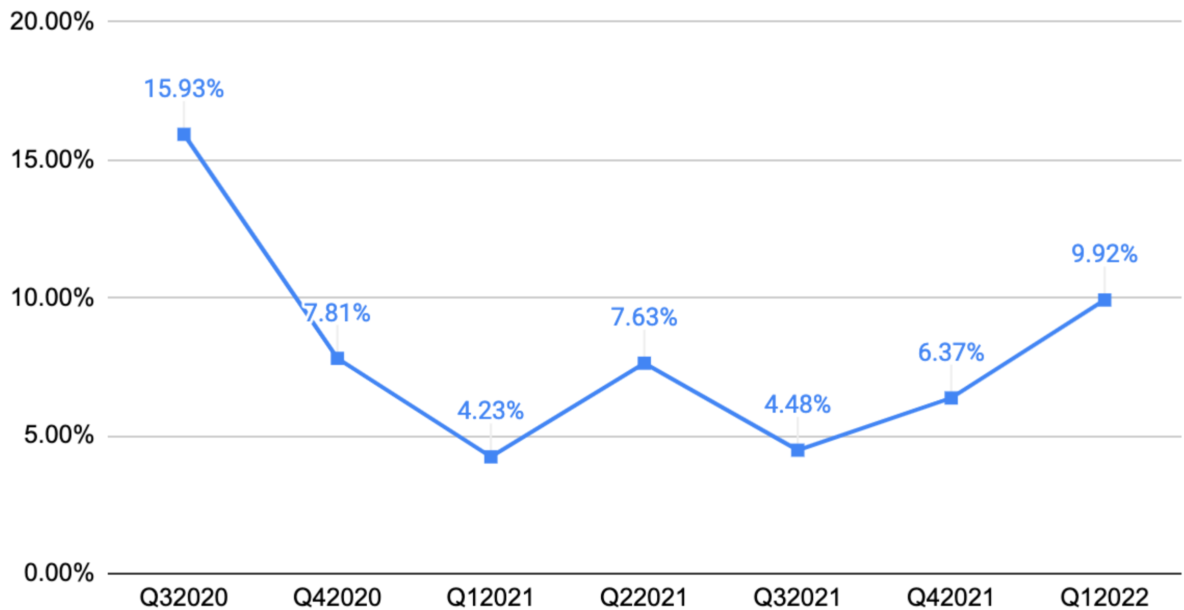

Chart Five.Upstart's R&D related loans on its balance sheet as a percentage of transaction volume[5]

In addition to USD $450 million in R&D related loans, the company has used about $150 million to fund personal loans originated through its platform. The company says that rapid repricing of credit due to increased interest rates resulted in the company holding some loans it would normally sell to investors. These loans of $150 million do not appear too significant or concerning at the moment, especially in comparison with the $4.5 billion total loan originations in the quarter. It is, however, crucial for the company to make its credit pricing more automated for the loan buyer side of the marketplace quickly, otherwise it will need to keep buying more loans when interest rates further increase. If the increase in the loans on the balance sheet gets prolonged, it will indicate that the company is unable to make its system for managing macroeconomic disruptions such as interest rate fluctuation more efficient and will make its business capital-heavy, greatly increasing its risk profile. Ten days after the publication of Q1 results, Upstart's Chief Financial Officer Sanjay Datta indicated that the company would likely scale back its lending volume if it observes weak demand for loans from investors, instead of placing loans on its balance sheet temporarily.[6]

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[5] Own calculation based on data from Upstart Quarterly reports
[6] Broughton, K. (2022). Fintech Lender Upstart Says It Won't Keep Excess Loans on Balance Sheet. [online] WSJ. Available at:

2. The company cut its revenue growth forecast for the year from $1.4B to $1.25B and said rising loan rates and increased risk in the economy may put higher pressure on the loan volumes facilitated through its platform than previously anticipated. Slowing growth this year, potential net loss, and a market in which interest rates are expected to further increase have concerned the market.

   Our take on this - The uncertain economic environment poses similar challenges to all the players in the industry, Upstart, with its sophisticated risk model, however, may have an edge over other competitors. As the lending risk increases, banks and lending institutions will require even more a model that separates risk and prices loans effectively. Furthermore, in an increasing lending risk scenario, institutions relying on traditional risk models will tend to reject more borrowers or charge a higher interest rate. This is likely to generate some additional traffic for Upstart's consumer facing platform- Upstart.com as the rejected or overcharged borrowers in the economy turn to Upstart in the hope of getting approved or charged a lower interest rate. As more potential borrowers come to Upstart.com, banks' interest in Upstart's referral network may be even more, Upstart may have an opportunity to increase its take rate without losing its referral network customers.
   Given the economic conditions and cyclicality of lending business, temporary decreases in origination volumes on the platform are to be expected, and those will affect revenue, as well as net income. However, Upstart's continued attractiveness to potential borrowers, banks and financial institutions, in a macroeconomic downturn, is a solid base for its future success, in our opinion.

We continue to remain confident about Upstart. Our confidence on Upstart is, of course, built on the assumption that Upstart's AI model will continue to evolve and price loans more effectively than the competitors, even during the times of uncertain macroeconomic headwinds, and that the company will be able to adjust its model in a timely manner to any further shocks in the economy.

Here are a few indicators that show that Upstart's model has been performing well and is geared for superior performance

1. Upstart now has 11 lenders with no minimum FICO score in their credit policies, up from 7 in the last reporting period. These lenders are solely relying on Upsart's predictive capability to accurately assess risk.

2. Upstart's model has been separating and predicting risk more effectively than FICO scores. As can be seen below in table one, an "E"- as per Upstart's methodology but 700+ as per FICO methodology has the default rate of 9.2% indicating that they were high risk borrowers that FICO could not capture but Upstart could. Similarly, an "A+"- as

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https://www.wsj.com/articles/fintech-lender-upstart-says-it-wont-keep-excess-loans-on-balance-sheet-11652959800.

per Upstart's methodology but "639 or below" as per FICO methodology has the default rate of only 1.2% indicating that those low-risk borrowers would have been charged higher interest rates if FICO's methodology was used.

On an average, Upstart has lower default rates in every category of borrower aside from "639 or below " (FICO) and "E-" (UPST). The higher default rates in the riskiest category does not indicate underperformance. As Upstart's model pushes incorrectly categorised low-risk borrowers from high risk category to low risk category, and vice versa, the average default rates will naturally decline in the low risk category and increase in the high risk category. As long as Upstart is able to accurately predict and segment different levels of default (high and low, sub prime and prime) and then sell those loans to different institutions depending on their risk tolerance and return requirement.

Annualized Default Rates as of Mar'22 (Prior 4 Yr Vintages)[2]

Upstart AI continues to separate risk significantly more accurately than traditional underwriting.

		Upstart Risk Grade					
		A+	B	C	D	E-	Averag
FICO Score	700 or Above	0.6%	2.0%	3.9%	6.0%	9.2%	3.4%
	680 - 699	0.7%	1.9%	3.6%	5.1%	8.3%	4.1%
	660 - 679	0.7%	1.9%	3.5%	5.1%	8.0%	4.8%
	640 - 659	1.0%	2.0%	3.2%	5.0%	8.3%	5.4%
	639 or Below	1.2%	2.1%	3.4%	5.2%	10.2%	7.7%
	Average	0.7%	2.0%	3.6%	5.3%	9.0%	

Table one. Upstart's Annualized default rates [7]

3. Data from disruptive periods and inclusion of macroeconomic variables are likely to build Upstart's models even stronger. If the company's model is able to learn in a timely manner and be resilient in the face of fluctuating macroeconomic factors, the company's competitive positioning could be further strengthened.

[7] Upstart Q1 2022 earnings presentation.

Besides its superior AI product, Upstart's business fundamentals continue to remain strong:

- Upstart is expanding its total addressable market (TAM) into new categories including huge auto loan and auto retail market, small dollar loans and loans for small and medium sized businesses demonstrating a large market opportunity.
- Upstart's margins and unit economics have generally seen improvements and will likely continue in that trend as a result of increased automation and scale (see chart six below).
- The company continues to find new banks to participate in its lending program. It now has 57 banking partners, up from 42 at the end of the year and 500 dealerships. An increasing number of these banks have dropped the use of minimum FICO scores as part of their own loan underwriting process as mentioned above.
- Even with the macroeconomic headwinds and lowered expectations, Upstart's growth story continues. It grew 156% in this quarter and, even with the revised guidance, the management expects it to grow 47% in FY22 (see chart seven).

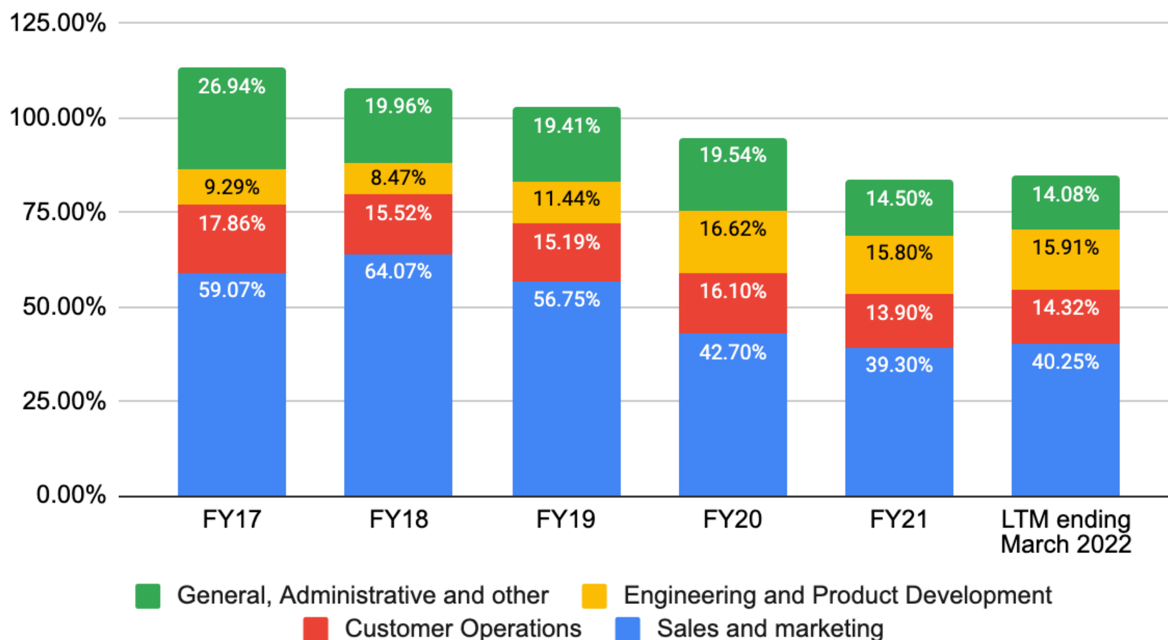

Chart Six. Upstart Expenses as a portion of revenue[8]

[8] Data from Factset, Upstart Annual reports

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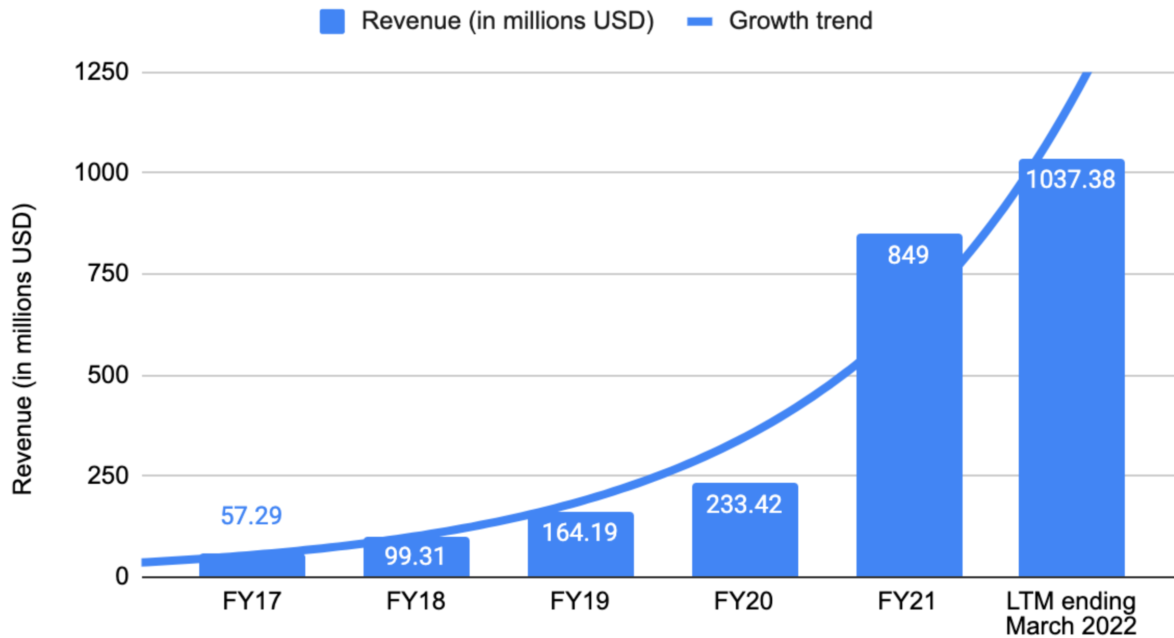

Chart Seven. Upstart's revenue growth[9]

Upstart is a key disruptor in the consumer finance space. It has disrupted consumer personal lending, and is set to disrupt auto lending, lending to small businesses, and small dollar lending. It is cash flow positive. Its models appear to be predicting credit risk effectively and are also being improved through the addition of macro-economic variables. Though the future economic environment is uncertain, we don't think there is an existential threat to Upstart, rather there may be an opportunity for advantageous evolution. The plummeting of its share price in the wake of its Q1 performance is largely an overreaction in our opinion.

[9] Data from Factset

dLocal

Cash Position: $410 million
Long-term debt: $6 million

Since our last newsletter, dLocal has reported 2021 fourth quarter and Full Year Financial Results as well as 2022 Q1 results.

Fourth Quarter and Full Year 2021 Financial Highlights

For the fourth quarter of FY21, Total Processed Volume (TPV) reached $1.9 billion, up 145% year-over-year from $757 million in the corresponding period in FY20. For the Fiscal year, TPV was up 193% year-over-year from $2.1 billion in 2020 to $6.0 billion in FY21.

Revenue growth was no less impressive, amounting to $76.3 million in the fourth quarter, it increased 120% year-over-year from $34.7 million, and 11% sequentially compared to $68.6 million in the third quarter of FY21. For the full year, revenues amounted to $244.1 million up from $104.1 million the previous year, representing 134% year-over-year growth (see Chart eight below).

Gross profit for the fourth quarter increased 88% YoY to $38.9 million and up 117% for the year amounting to $130.4 million. The adjusted EBITDA margin was 38% for the quarter compared to the same period the previous year and 41% for FY21.

Net income for the fourth quarter was up 103% YoY, amounting to $23.55 million and up 176% YoY for the full year, amounting to $77.85 million.

First Quarter FY22

dLocal has been resilient despite the challenging global macro environment with high interest rates, higher inflation in some markets, and the Russia-Ukraine conflict, posting impressive results for the first quarter of the Fiscal Year 2022.

TPV increased 127% YoY in the quarter reaching $2.1 billion from $926 million in the first quarter of 2021.

Revenue increased from $40.3 million in the first quarter of 2021 to $87.5 million, for year-over-year growth of 117%. Sequentially, revenue increased 15% compared to $76.3 million in the fourth quarter of 2021.

Gross profit grew 87% YoY to $43.6 million in 1Q22 from $23.3 million in 1Q21. Gross profit was up 12% sequentially compared to $38.9 million in the fourth quarter of 2021.

Adjusted EBITDA was $32.9 million in the first quarter of 2022, up 84% year-over-year compared to $17.8 million in the first quarter of 2021 and 13% compared to $29.1 million in the fourth quarter of 2021.

Net income increased 55% year-over-year to $26.3 million in the first quarter of 2022. Sequentially, it grew 11.6% compared to $23.55 million in the fourth quarter of 2021.

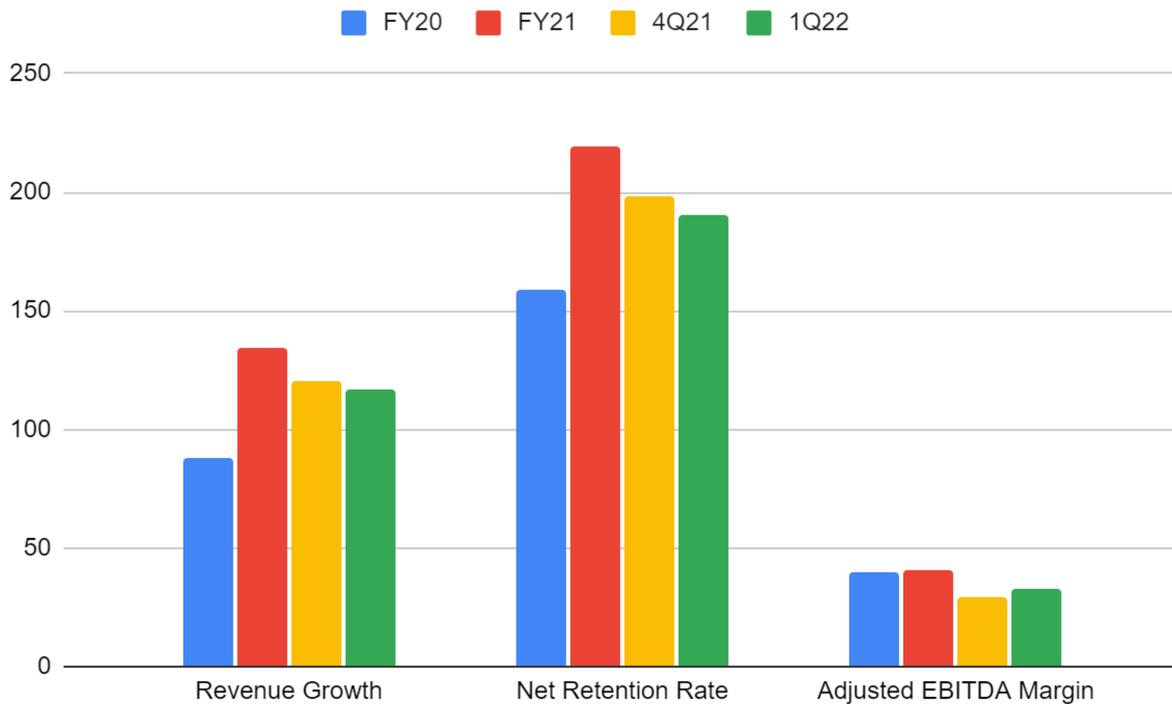

Chart Eight. dLocal Key Metrics[10]

dLocal's resilience comes from its diversity across verticals and geographies. Their business does not depend on any particular industry vertical or region. The TPV growth in the last two quarters was driven by the continued growth of their merchants across most verticals particularly Saas ("software as a service"), on-demand delivery, advertising and commerce.

dLocal continued with its geographical expansion adding Pakistan, Tanzania and Uganda to its network in the fourth quarter of 2021 and Ivory Coast and Rwanda in the first quarter of 2022 bringing the total number of countries dLocal makes its services available to 37. Typically, the company would have a merchant waiting prior to adding a new country to its list. This helps them generate a high return on investment (ROI) on their expansion into a new country. Revenue across all regions continued to increase with LatAm growing 116% and 140% and Asia

[10] dLocal reports

& Africa growing 127% and 86% YoY in the first quarter of 2022 and last quarter of 2021 respectively.

In the first quarter of FY22 LatAm contributed 89% of the total revenue while the remainder came from Asia & Africa.

During the last two quarters, the company continued delivering strong revenue growth both from existing and new customers. While revenue from existing customers increased by $33.9 million in the fourth quarter of 2021, it increased by $36.3 million in the first quarter of 2022.

dLocal have guided EBITDA margin north of 35% and net retention rates over 150% for Fiscal Year 2022.

Doximity

Cash on hand**:** $ 112.8 million

Long-term debt: NIL

Doximity is a digital platform that allows medical professionals to communicate and share confidential information with patients and colleagues – all while being HIPAA-compliant, staying up-to-date with the latest medical news and research, earning CME credits and managing their careers. Doximity is free for its members. The company makes revenue by selling marketing solutions to pharmaceutical companies, and hiring and telehealth solutions to health systems.

Doximity delivered $93.7 million in revenue for Q4 of FY22, up 40% year-over-year (see chart nine below). Quarterly net income was $36.7 million, up 71% year-over-year. For the full year, the company reported a revenue of $343.5 million, versus $206.9 million in FY21, an increase of 66% year-over-year. FY22 net income was $154.8 million, an increase of 208% year-over-year.
On the physician user side, the company saw record use of its fax, e-signature and telehealth tools and added scheduling to its product suite with the acquisition of Amion.

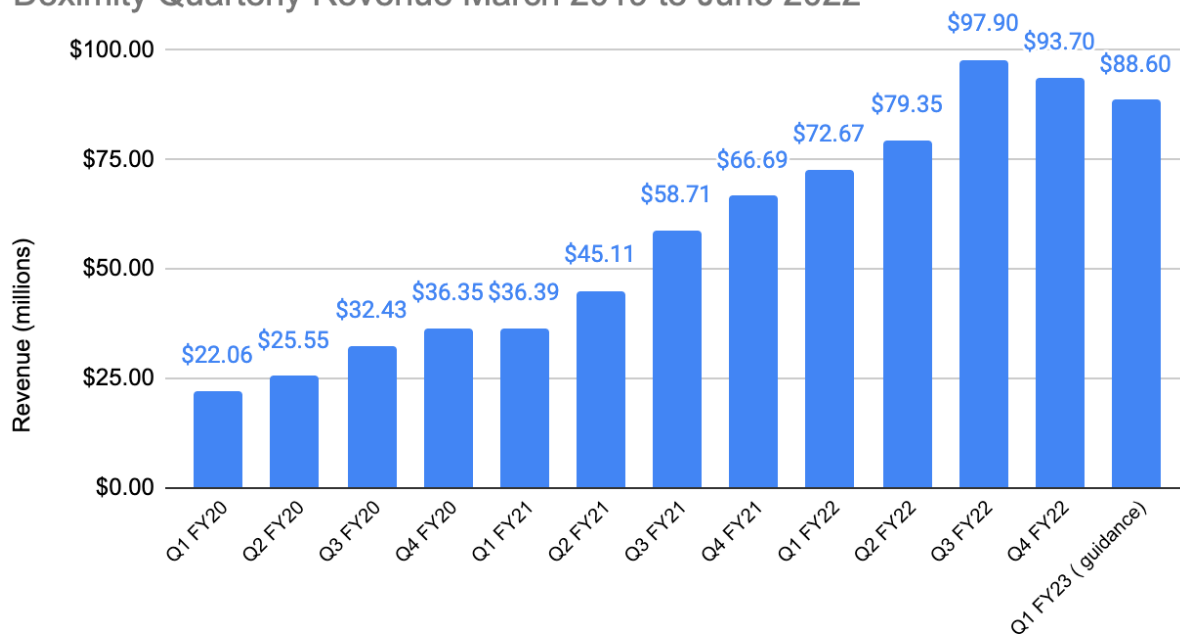

Chart Nine. Doximity quarterly revenue[11]

Doximity Inc. shares plunged toward all-time lows in after-hours trading Tuesday, following a sequential revenue decline in Q4 FY22 and a projected sequential revenue decline in Q1 of FY23 (see chart Nine). Furthermore, its net revenue retention rate declined from 171% to 157% in the period. (See Chart Ten)

[11] Doximity Quarterly reports

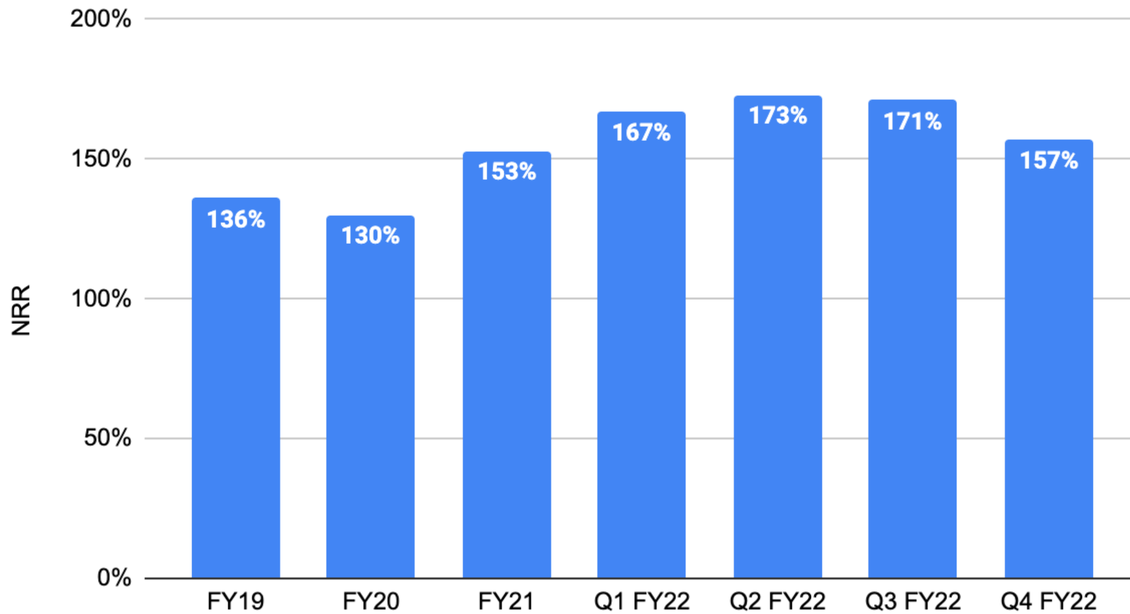

Chart Ten. Doximity Net Revenue Retention Rate.[12]

These declining trends were not entirely unexpected. The company is emerging after two years of accelerated demand due to Covid. As some live pharma marketing resumes, the company's growth is bound to normalise. This coupled with seasonality and slower approvals has impacted the company's quarterly revenue spread. The company's year on year growth in these quarters is still high and for FY 2023, management expects revenue to grow 32%. Revenue in FY23 will include a few million from Amion acquisition as well. This is close to their growth rate during the pre-pandemic period (see chart eleven).

[12] Data from Doximity Reports. Net revenue retention rate is calculated by taking the trailing twelve months (TTM) subscription-based revenue from the customers that had revenue in the prior TTM period and dividing that by the total subscription-based revenue for the prior TTM period.

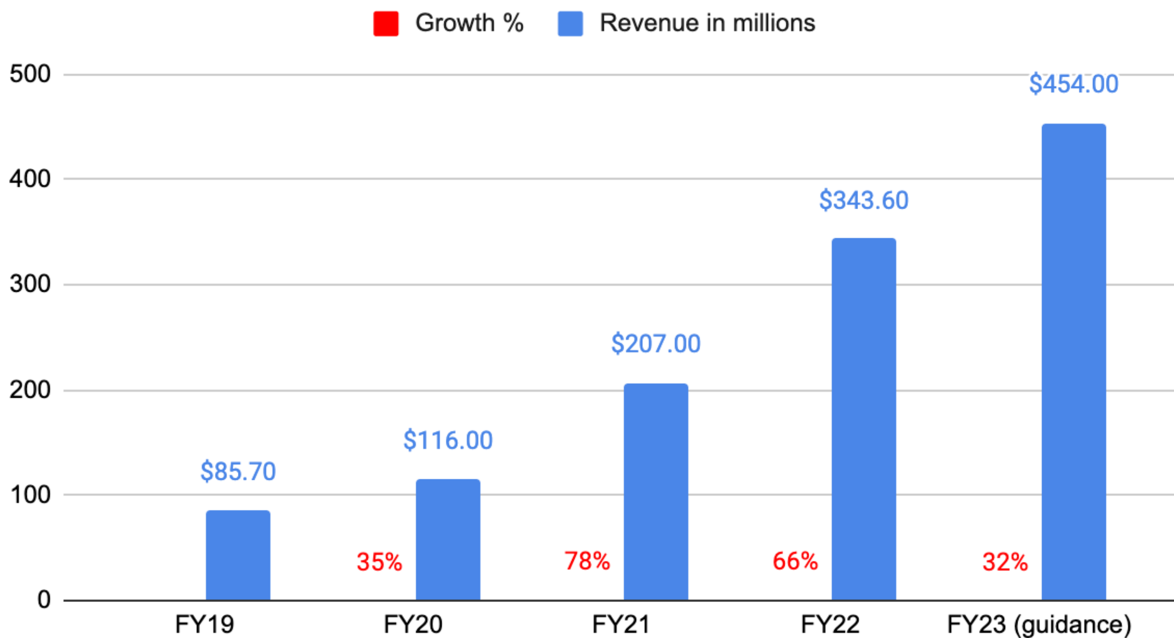

Chart Eleven. Doximity full-year revenue growth[13]

Despite the sequential revenue decline in Q4, Doximity's operating cash flow increased from 27.4 million in Q3 to 47 million in Q4, and its free cash flow increased from 25.6 million in Q3 to 44.9m in Q4.

Strong growth in the pharma market represents a big tailwind for Doximity. Though relatively slower than during the pandemic, there is an ongoing shift to digital among Doximity's larger established clients . Moreover, Doximity has strategically started targeting mid- tier pharma companies as well. These smaller, new, innovative companies are able to build their marketing programs around digital more quickly and spend a much larger share of their marketing budget on digital. These factors, along with Doximity's strong business fundamentals and its ability to add meaningful products to its overall product suite make us confident about Doximity's future growth.

Doximity has authorised a new stock repurchase program to acquire up to $70 million of its Class A common stock, beginning in the first quarter of fiscal 2023.

[13] Data from Factset and Doximity Q4 2022 results brief.

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Paycom

Cash position: $361 million
Long-term debt: $26.9 million

Paycom offers cloud-based payroll and human capital management (HCM) software solutions delivered as Software-as-a-Service for big and small companies. They offer functionality and data analytics needed by businesses to manage the complete employment life cycle from recruitment to retirement and make for a seamless user experience. Their services include Payroll, HR Management, Talent Acquisition, Talent Management and Time and Labour Management.

Paycom delivered strong results in the first quarter of FY22 with revenues of $353.5 million, up 30% year-over-year. Net income for the quarter increased 42% year-over-year, amounting to $91.9 million.
The increase in revenue was attributed to strong growth in recurring revenue from new business sales and modestly better revenue from seasonal forms, fillings and adjustments.

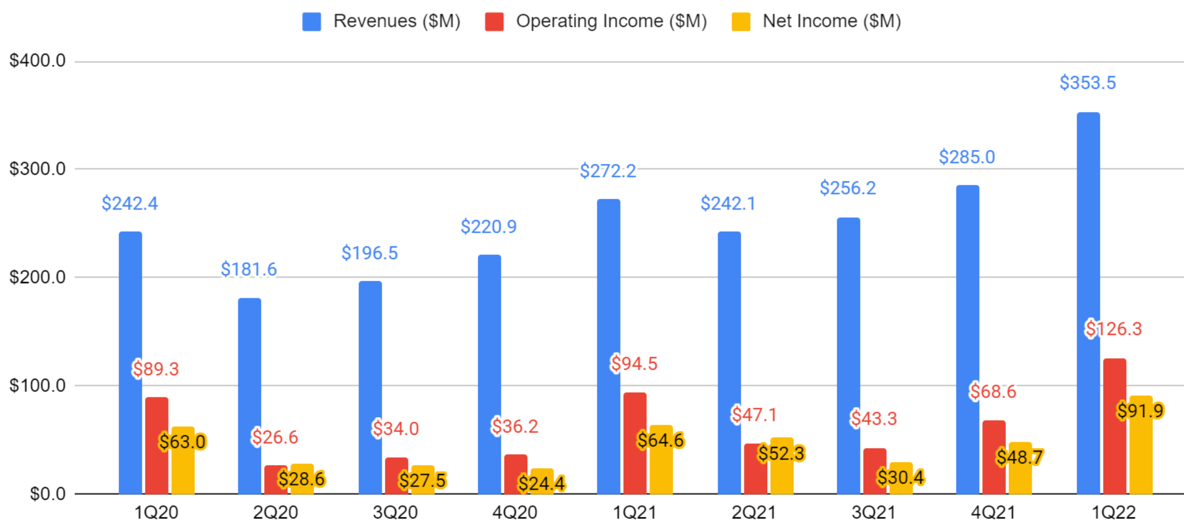

Chart Twelve. Quarterly Revenues, Operating Income and Net Income ($ millions)[14]

[14] Paycom Financial Exhibits (8-K reports)

Operating Margin and Net Margin

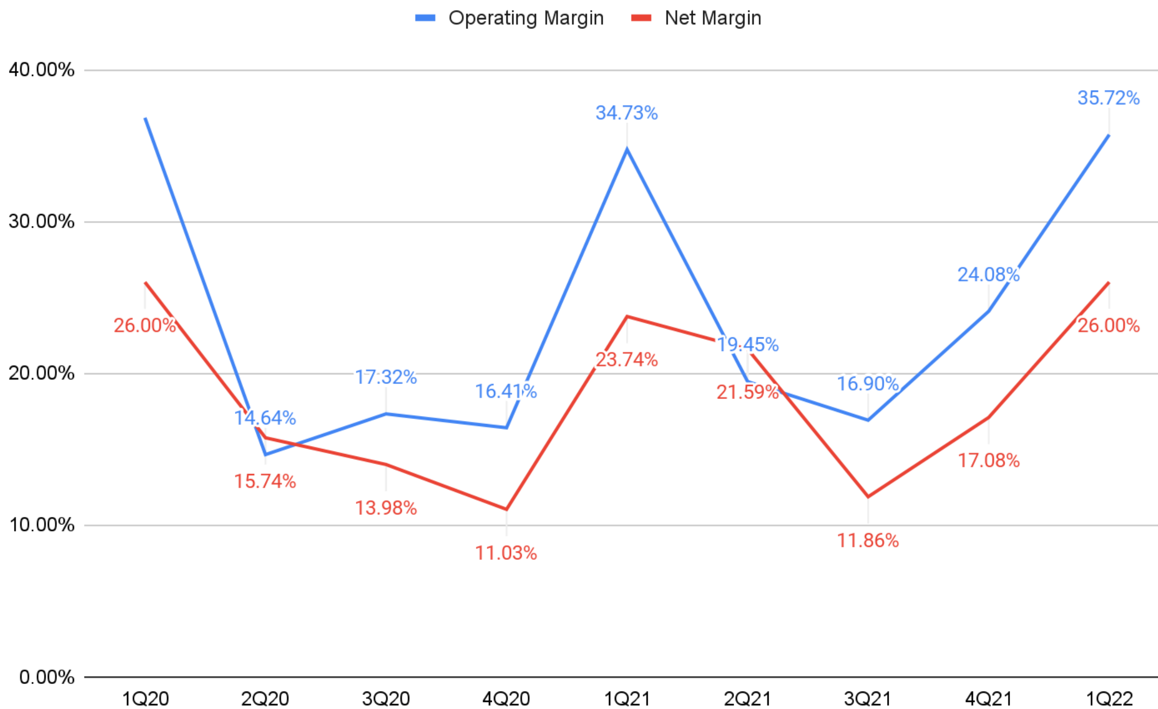

Chart Thirteen. Quarterly Operating and Profit Margins[15]

Recurring revenue for the quarter was $348.2 million or 98% of total revenue. GAAP net income grew 42.2% over the same period last year to $91.9 million (See chart twelve above). As seen in chart thirteen above, margins continue to improve with Net Income margin at 35.7% and Operating margin at 26%.

Cash and Cash Equivalents at the end of the first quarter increased to $360.6 million up from $277.9 million the previous quarter. Long-term debt marginally decreased from $27.4 million to $26.9 million.

Beti adoption continued to grow with over 10,000 or well over a quarter of their clients using it since its adoption less than a year ago. Paycom will continue to innovate Beti to deliver even more value to their clients and make it even more compelling.

The first quarter has set Paycom up to deliver strong performance for the remainder of the year. They have raised their full-year guidance to the range of $1.333 billion to $1.335 billion or 26% year-over-year growth at the midpoint of the range.

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[15] Paycom Financial Exhibits (8-K reports)

Alfen

Cash on hand: €47.28 million
Long-term debt: €3.73 million
(FY21 figures. No data available for 1Q 2022)

Alfen provides high quality and smart end-to-end energy solutions operating at the core of the energy transition. Their business lines span Electric Vehicles (EV) charge points, smart grids, and energy storage with a variety of in-house developed and integrated solutions available to their clients across multiple countries in Europe. The group also offers management and maintenance services for each of its business lines by means of separate contracts.

Q1 FY22 revenues grew a record 77% year-on-year from €53.8 million to €95.5 million (see chart fourteen below). This growth was primarily driven by the EV Charging segment growing 185% year-on-year. The Smart Grids segment also contributed with 23% YoY growth. The Energy Storage segment, on the other hand, decreased by 6% compared to the same quarter last year due to timing of payments being deferred past the reporting period.

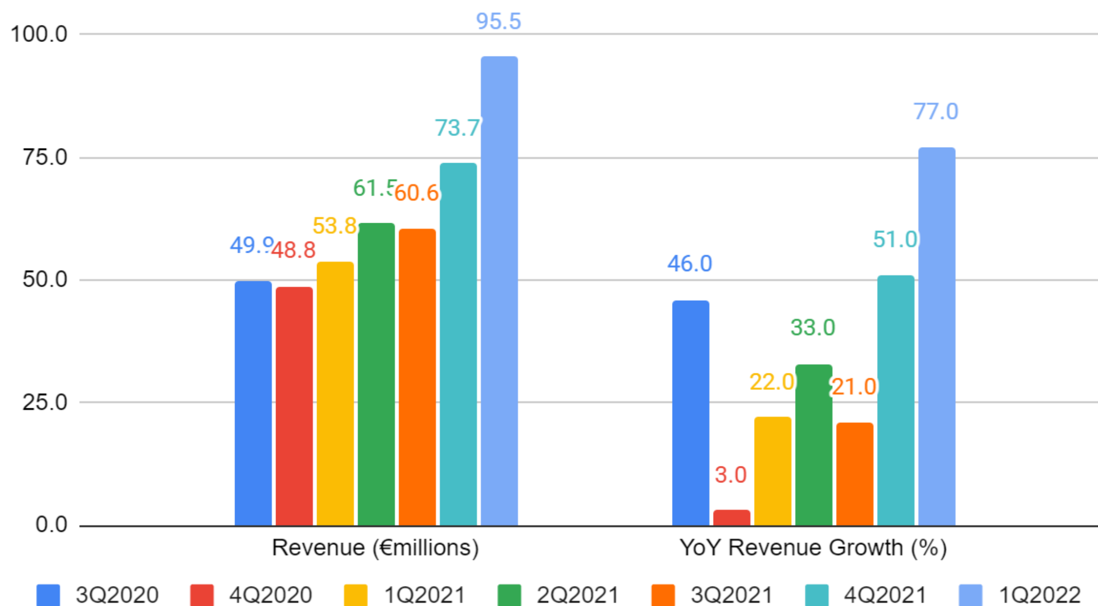

Chart Fourteen. Alfen Quarterly Sales[16]

Alfen benefited from higher EV adoption in its core markets leading to strong demand for EV charge points in all segments: at home, in semi-public places like offices, and in the public segment for on-street parking. In Q1 2022, Alfen produced approximately 64,600 charge points, a growth of 211% from Q1 2021.

Alfen's Smart Grids segment saw rather low revenues in Q1 last year driven by the pandemic and the production ramp-up of a new and innovative substation range for Enexis. We still continue to see long-term growth tailwinds for smart grid solutions. This is underpinned by the recent publication of investment plans for 2022-2024 by the Dutch grid operators. In Q1 2022, Alfen produced approximately 845 substations, an increase of 22% from Q1 2021.[17]

In the Energy Storage segment, while Q1 revenues decreased approximately 6% to €6.4 million compared to €6.8 million last year, Alfen's backlog remains strong driven by new contract wins.

Gross margins in 1Q 2022 decreased slightly to 35.7% compared to 36.5% in 1Q 2021. On the other hand, adjusted EBITDA margin saw a significant increase from 13.4% in 1Q 2021 to 17.9% in 1Q 2022 (See chart fifteen below). This showcases the pressures on the global supply chains as well as the increased operating efficiency achieved by Alfen.

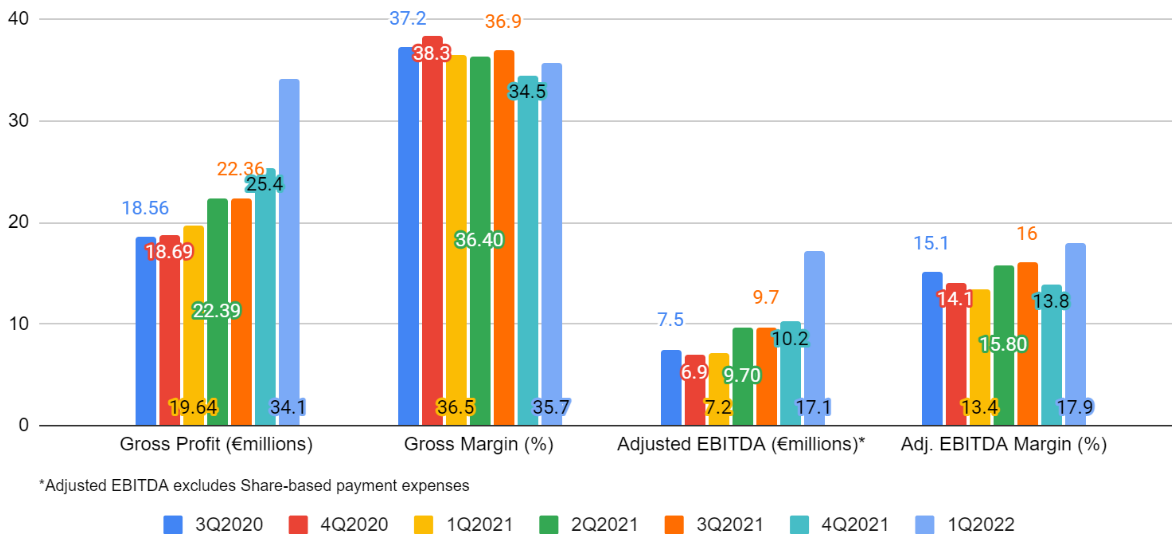

Chart Fifteen. Alfen Gross Profit and Adjusted EBITDA[18]

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[16] Alfen Interim reports and quarterly trading updates
[17] Alfen Q1 2022 trading update
[18] Alfen Interim reports and quarterly trading updates

Alfen has been able to manage the various supply chain challenges till now. Pressures on the supply chain have been intensifying over the past few months. Alfen expects this to continue to have an impact on its markets in 2022 and 2023. Meanwhile, the transition to a carbon-free energy system continues to build momentum across Europe and Alfen anticipates long-term positive market developments for all its business lines.

For FY22, Alfen increased its full year revenue outlook from €330-370 million to €350-420 million.

Nu Holdings Ltd

We've recently taken a position in Nu holdings. Nu is a digital bank based in Brazil that offers a variety of financial products in Latin American markets. Nu has been regarded as the largest neobank in the world in terms of the number of customers. By giving consumers and small and medium enterprises (SMEs) easy access to better financial products, Nu is empowering millions and making a positive impact in their lives.

Serving the unbanked and the underserved

According to the World Bank, access to a bank/transaction account is the first step towards broader financial inclusion, and a transaction account may serve as a gateway to other formal financial services[19].

Having a bank account is associated with several positive impacts for households and businesses. In Latin America, multiple costs were found to be associated with being unbanked.[20] In Mexico, for example, paying for public services at a commercial bank cost more for non-account holders. Both paying bills and receiving payments in cash require physical movement and can be costly in terms of transportation and time. Turning a paycheck or a deposit to a third-party account into ready cash is costly for persons without bank accounts. They may have to change cheques in commercial stores (in return for purchases) or at money changers, for a fee. Similarly, the costs of remittances and borrowings are usually higher for an unbanked person. Bank accounts allow families to greatly reduce such costs of paying for services and cashing cheques. Another benefit of having a bank account, especially for low-income persons, is to be able to receive government welfare payments directly into their

[19] World Bank. (2020). Overview. [online] Available at: https://www.worldbank.org/en/topic/financialinclusion/overview#3

[20] Solo, T.M. (2008). Financial exclusion in Latin America — or the social costs of not banking the urban poor. Environment and Urbanization, 20(1), pp.47–66.

accounts without any intermediaries and without any risk of fraud. In India, for example, with a comprehensive digital infrastructure in place, the government was able to facilitate 106.75 million welfare payments directly to eligible people's bank accounts preventing USD7 billion worth of wastage in double-dipping and ineligible payouts.[21]. People without bank accounts may face difficulties in receiving government aid. For example, with the Brazilian government's Covid emergency cash-transfer scheme for low-income families, there were numerous instances of fraudulent and mistaken payments[22], which made it harder for the genuine and vulnerable families to receive the aid.

Despite the above-mentioned benefits, many consumers, especially consumers with low-income or informal jobs are deterred from opening bank accounts due to high monetary and non-monetary barriers associated with opening and using bank accounts. These barriers include the requirement to maintain a minimum balance, account fees, and non-monetary costs, like distance to the nearest bank. Lack of trust in traditional financial institutions coupled with inadequate knowledge is another barrier for low-income people. In some instances, people simply may not have enough income to make using their account worthwhile.[23]
In Brazil, the banking and financial services industry has been largely oligopolistic and dominated by five major players: Banco Itau, Banco Bradesco, Santander, Caixa Economica Federal and Banco do Brasil. These banks have held about 80% of financial system assets and enjoyed attractive and undisputed margins for decades[24]. Brazil's Minister of the Economy, Paulo Guedes, has even called the big Brazilian banks a cartel.[25] Unfortunately, the prevailing less competition gave the incumbent Brazilian banks little incentive to reduce the above-mentioned barriers, test new financial products, improve customer service and

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[21] Pazarbasioglu, C., Mora, A., Uttamchandani, M., Natarajan, H., Feyen, E. and Saal, M. (2020). DIGITAL FINANCIAL SERVICES April 2020. [online] Available at: https://pubdocs.worldbank.org/en/230281588169110691/Digital-Financial-Services.pdf.

[22] The Brazilian Report. (2020). Government recovers BRL 42 million from coronavirus aid fraud. [online] Available at: https://brazilian.report/liveblog/coronavirus/2020/06/26/coronavirus-aid-fraud/

[23] The Abdul Latif Jameel Poverty Action Lab (J-PAL). (2020). Reducing the costs of saving. [online] Available at: https://www.povertyactionlab.org/policy-insight/reducing-costs-saving.

[24] SPGlobal.com. (2020). Brazil invites competition to challenge its banking 'oligopoly'. [online] Available at: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/brazil-invites-competition-to-challenge-its-banking-oligopoly-61114095.

[25] Ayres, M. (2019). Brazil economy chief slams 'excessive' bank profits, urges competition. [online] U.S. Available at: https://www.reuters.com/article/us-brazil-economy-competition-idUSKCN1T52RW .

accessibility, or reduce fees. This situation led to dissatisfied customers on the one hand and excluded a large population from the formal banking system on the other.

Nubank has been able to bring millions into the formal banking system by eliminating barriers such as complexity, bureaucracy, fee and minimum balance requirements, the need to travel, and by creating a superior user experience. It has disrupted the inefficient, low tech and inaccessible Latin American financial ecosystem and set an example for others to follow.
The company's digital savings NuConta is a 100% digital smartphone app, a maintenance-free prepaid account allowing customers to check their balances, send and receive payments, earn interest, charge up their mobile cards, etc. It's free of complexity and doesn't charge a fee for opening/maintaining an account or transferring money. They have opened 43 million bank accounts including 5 million from first-time users. The digital account comes with a zero-fee Mastercard-branded debit or international credit card with which users can make in-store payments, earn cashback rewards, and withdraw money from ATMs.

The credit card, in fact, was Nu's first product in Brazil. When Nubank released its ground-breaking credit card, it was competing against traditional finance firms that charged fees and high interest to consumers. For the high-volume or affluent consumers, the accompanying rewards that came with high credit card usage more than neutralised the high fees. However, for the low income, low usage consumers, credit card fees were a big burden. Nu's credit cards came with zero annual fees, offered better terms, and provided quick approvals. Moreover, they provided a much better user experience and were fully operational through a mobile app. The app allowed its users to track transactions in real-time, block their respective credit cards, apply for a limit raise and contact customer support. Furthermore, Nu offered a line of credit as low as USD10 to get customers into the system and increased it as customers built up a history of good payments.[26]

It can be said that credit card has been Nu's most crucial offering. By challenging and disrupting the traditional credit card industry, increasing competition, and setting a successful example that others could follow, Nu has created a positive impact on the overall Latin American financial ecosystem, benefiting consumers. From the company's strategic viewpoint too, it was wise to launch credit cards before other financial products. The credit card was a low-cost structure, revenue-generating product and had a relative advantage over other financial products Nu could have launched at that time. The credit card attracted and continues to attract millions of underbanked, young, loyal customers to Nu. The company claims that its vision with respect to credit cards is fundamentally different. They position credit cards primarily as tools for their clients to make payments and organise their finances and use credit card limits only in times of necessity.[27] The company even classifies credit cards as 'spending products' rather than 'borrowing products'. To encourage responsible financial behaviour from customers, Nu

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[26] Hbs.edu. (2020). Nubank: Democratizing Financial Services - Case - Faculty & Research - Harvard Business School. [online] Available at: https://www.hbs.edu/faculty/Pages/item.aspx?num=58873.

[27] Nu Holdings Prospectus

provides financial education content through several digital channels that are followed by millions. As per Velez, the company's CEO, 91% of Nu's credit card consumers have paid their credit card bills on time and 9% have rolled over their balances as compared to the industry average of 70% and 30% respectively.[28] The success of credit cards paved a way for a multitude of opportunities for Nu to launch new products and increase the customer lifetime value of existing products.

Nu's other credit product is personal loans. By using unique data and an advanced credit engine, Nu manages credit risk more effectively and has lower fraud rates than incumbent banks. Lower fraud rates make way for lower interest rates. As compared to making decisions with generic credit bureau scores, Nu's credit engine decreases risk by 60% for a comparable approval rate. This enables the company to price its products more competitively, and have higher approval rates while still generating advantaged unit economics. The superior and evolving credit engine has allowed the company to triple its approval rate from 14.9% in the quarter ended September 30, 2020, to 41.9% in the quarter ended September 30, 2021[29]. By approving loans for people who were denied loans earlier based on their credit histories, and by creating opportunities for lower interest rates on loans, Nu is facilitating financial inclusion and providing a safer alternative to debt traps from loan sharks for individuals and small businesses.

In addition to business savings accounts, credit cards and personal loans, Nu offers premium credit cards, life insurance, investment products and an e-commerce marketplace. The company reports that more than 67% of its customers say they've become more financially independent after using Nu's financial services and 80% say they could overcome unforeseen financial issues as a result of using Nu's credit products.[30] Nu's products are not only meant to financially empower consumers but are also important engines for the company's current and future growth.

Drivers of growth

1. Favourable e-commerce trends
   In Brazil, e-commerce is still a nascent market with online sales accounting for just 4.3 per cent of total retail spending. The Brazilian e-commerce market has been expanding at a steady double-digit rate since 2017. Though the e-commerce growth is expected to slow to a compound annual growth rate (CAGR) of 9.3 per cent to 2023, reflecting wider economic pressures created by COVID-19, mobile commerce is expected to outperform

[28] Same as 8
[29] Same as 9
[30] Jpmorgan.com. (2020). 2020 E-commerce Payments Trends Report: Brazil Country Insights. [online] Available at: https://www.jpmorgan.com/merchant-services/insights/reports/brazil-2020#footnote-src-19.

the overall e-commerce and grow at a compound annual growth rate of 17.8 per cent to 2023.[31] This presents a great opportunity for Nu, primarily in 4 ways-

- The growth of e-commerce will facilitate further penetration and usage of credit/debit cards and digital payments.
- With bill payments and credit card bill management directly through the mobile app, Nu is even better positioned to take the advantage of the favourable m-commerce trends.
- In Nov 2021, Nu launched its e-commerce marketplace, pulling leading Brazilian retailers directly into its app so that customers can shop, order and pay all without leaving the Nu app. Having an e-commerce marketplace will boost customer engagement and will drive customers to buy from the Nu app itself using Nu's payment products, rather than from any other e-commerce platform using any other card/payment option they may have. This way Nu will be able to capture a greater wallet share of the already growing e-commerce payments wallet of its existing customers resulting in an increase in revenue from interchange fees.
- Given the continuing growth in e-commerce and m-commerce, Nu's additional marketplace revenue in the form of 'take- rate' is also poised for strong growth.

2. A growing suite of relevant financial solutions in growing market segments.
   Since the company started operations in 2013, it has launched several products including a loyalty rewards program, personal loans, PIX, life insurance, investments products, Buy Now Pay Later etc, in addition to cards and payment accounts. In the quarter ended March 2022, Nu launched two new products- NuPay and NuCripto. NuPay, a payment solution for online purchases integrated with e-commerce checkout and Nucripto, which allows crypto trading starting from R$1.
   Product improvement and expansion will boost revenue in the following ways-
   - As existing customers become more engaged and satisfied with the app and Nu's core products, they will sign up for more Nu products or use existing products more boosting average revenue per existing customer. Furthermore, since there is no additional spending on customer acquisition, there will be a positive impact on the profitability as well.
   - Multiple superior products provide multiple avenues to acquire new customers either by tapping into unserved consumers or winning customers from competitors. For example, the Brazilian stock market is expected to draw in new investors at a pace of 1 million to 2 million per year[32]. Nu is set to benefit from this opportunity as it already has a competitive investment product. Similarly, by providing all the essential services customers need, the company has the opportunity to attract dissatisfied customers from its competitors. It is noteworthy

[31] Nu Holdings Annual Report 2021

[32] Spglobal.com. (2021). How technology and low rates are changing the face of Brazil's stock market. [online] Available at: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/how-technology-and-low-rates-are-changing-the-face-of-brazil-s-stock-market-62183476

that Nu has an excellent Net Promoter score of 90 and above. It averages 269 complaints per one million customers where traditional banks average 1,420 complaints per one million customers.

The company expects to launch more products in the future, including additional credit products, other types of insurance policies, new investment solutions and other fee-driving businesses.

3. Increased mobile phone and internet penetration
   The Latin American region is expected to see almost 100 million additional smartphone connections in the next 4 years taking adoption above 80%. This will spur mobile internet adoption- projected to reach 64% penetration by 2025, enabling more people to access digital financial services for the first time. [33]

4. Geographical expansion
   Nu began operations in Brazil in 2014. In 2019 and 2020, it expanded internationally to Mexico and Colombia, respectively. The company followed a similar strategy and launched the flagship credit card product in both countries. In two years, Nu has become one of the top credit card issuers in Mexico with 2.1 million customers as of March 2022 and an NPS score of 94%. In Colombia, the company surpassed 200,000 customers in Q1 and has a waitlist of nearly 1 million customers.

   The company may expand its operations to other Latin American markets in the future.

5. Young customers
   The company reports that more than 70% of its customers are under 40 years old. This gives the company an opportunity to grow as those customers' income and wealth grow in the future.

High revenue growth and improving margins

The company's fundamentals are strong, marked by high revenue growth (chart seventeen), improving margins (chart twenty), increasing average revenue per customer and multiple avenues for future growth. In FY21, the company grew 114% with $1.7 billion in total revenue.

In its latest quarter ended March 2022, total quarterly revenue reached a record high of $877.2 million, increasing 226% year on year. The company's number of customers has increased from 3 million in 2017 to nearly 60 million in the latest quarter ended March 2022. (See chart sixteen). In this quarter, the company's monthly average revenue per active client rose to $6.7, up $3.2

[33] The Mobile Economy. (2021). The Mobile Economy Latin America 2021. [online] Available at: https://www.gsma.com/mobileeconomy/latam/ .

from a year earlier. On average, cost per client decreased to 70 cents per month from 80 cents a year ago. As of March 2022, the company has USD 2968.6 million in cash and cash equivalents as compared to USD 148 million in long term debt.

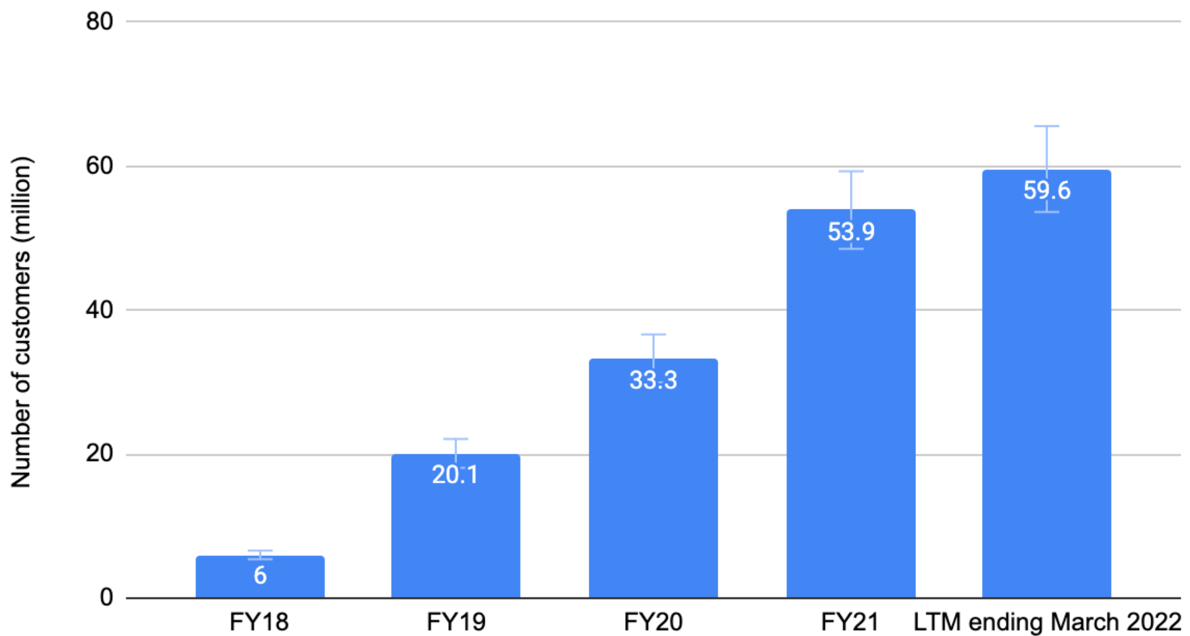

Chart Sixteen. Nu's number of customers at the end of each period[34]

[34]Nu annual and quarterly reports.

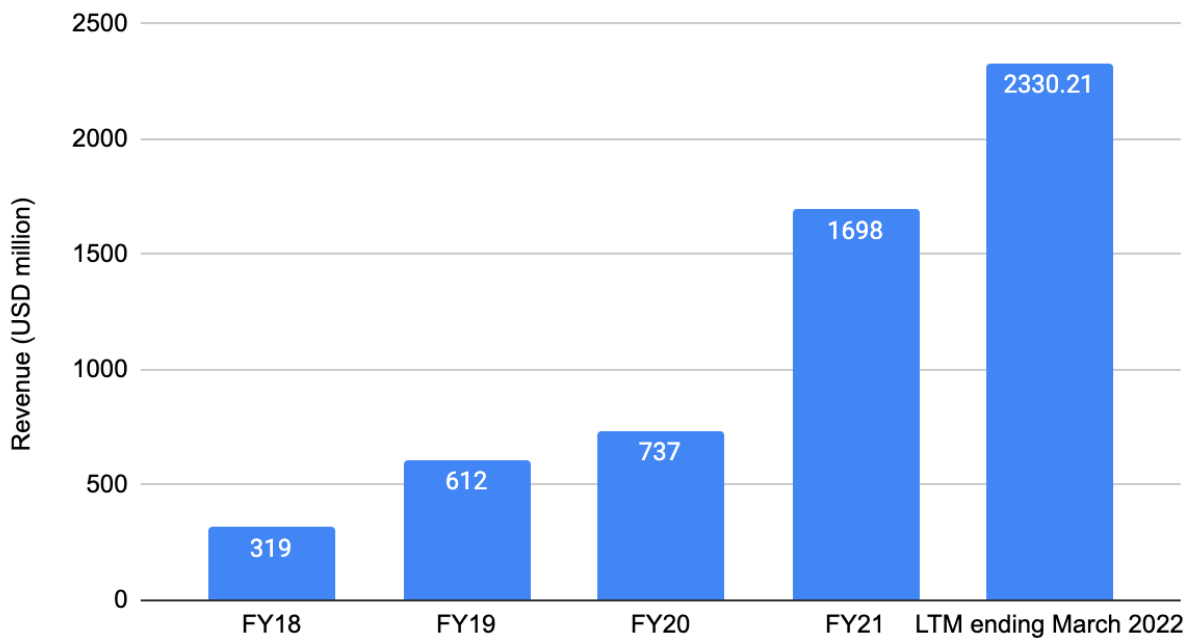

Chart Seventeen. Nu revenue growth[35]

Though reported net loss in this period was USD 45 million, a decrease of 9% from the net loss of USD 49.5 million in Q1 FY21, the cash flow generated from operating activities was USD78.3 million. The reported net loss is a result of higher credit loss allowance expenses on the company's P&L statement. Higher credit loss allowance expenses resulted from the rapid growth of Nu's Credit portfolio that increased 343% in Q1 reaching USD3.1 billion and related Expected Credit Losses (ECL). As per IFRS 9 standards, non-cash loan loss provisions have to be recognized upfront at the time a loan is granted and before it has generated any revenue. While Nu makes these (non-cash) loan loss provisions upfront, the Company expects to generate revenue from related credit card and personal loan customers over time, which generates a mismatch between the Company's credit loss allowance expenses and the expected revenues associated with them. This has negatively impacted Nu's gross profit (see chart nineteen) and gross profit margin, and will continue to impact in the same way in any period the company is expanding its interest-earning portfolio at a fast pace.And as growth rates normalise, gross profit margins are expected to converge over time towards those of mature cohorts.

[35]Data from Nu annual and quarterly reports.

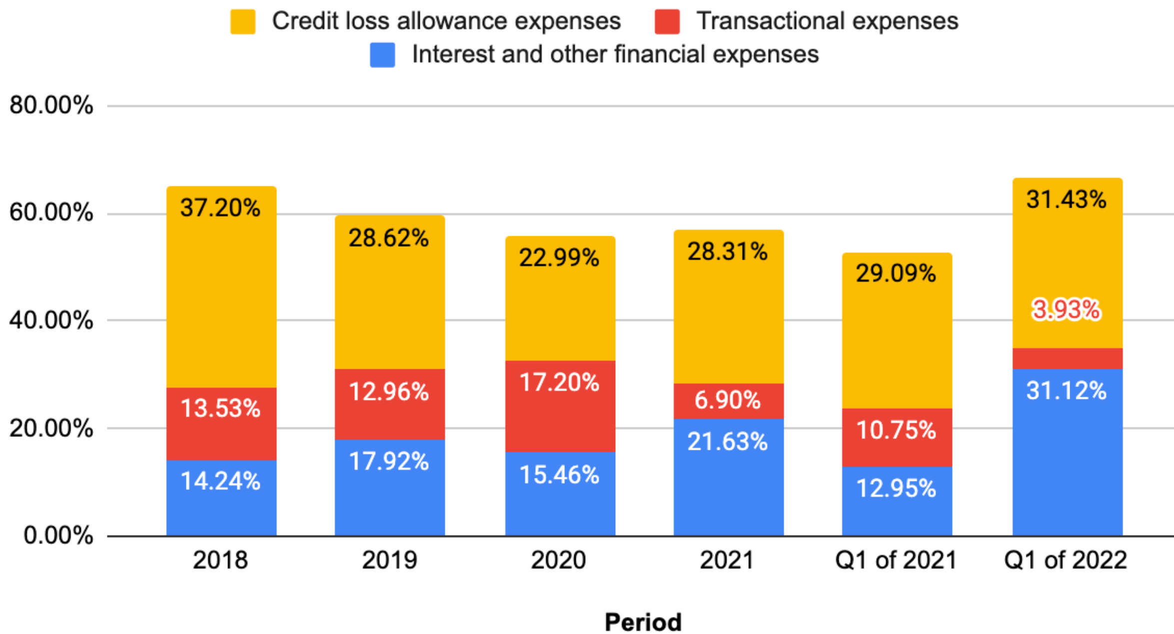

Chart Nineteen. Nu financial and transactional expenses as a percentage of revenue[36]

The gross profit margin was 34% compared to 47% in Q1 of 2021, reflecting the impact of ECL credit provisioning under IFRS 9, together with the dual impact of the higher interbank rate which increased interest expenses.

However, despite the non-cash credit loss provision disproportionately affecting its reported gross margin and profitability, the company still has been able to improve its reported operating income (see chart twenty below). Nu's decreasing average cost to serve due to scale; increasing revenue from cross-selling that doesn't require any additional customer acquisition expense and; increasing adoption of Nu's relatively high-margin products pave the way to its further overall efficiency and profitability.

Nu appears well-positioned to endure the ongoing deterioration in credit quality in Brazil as its portfolio skews toward low-risk, low-yielding credit card receivables. Additionally, its personal loans is exclusively a cross-sell product offered selectively to their lowest risk credit card customers.

[36]Data from Nu annual and quarterly reports.

BLUE OCEANS CAPITAL

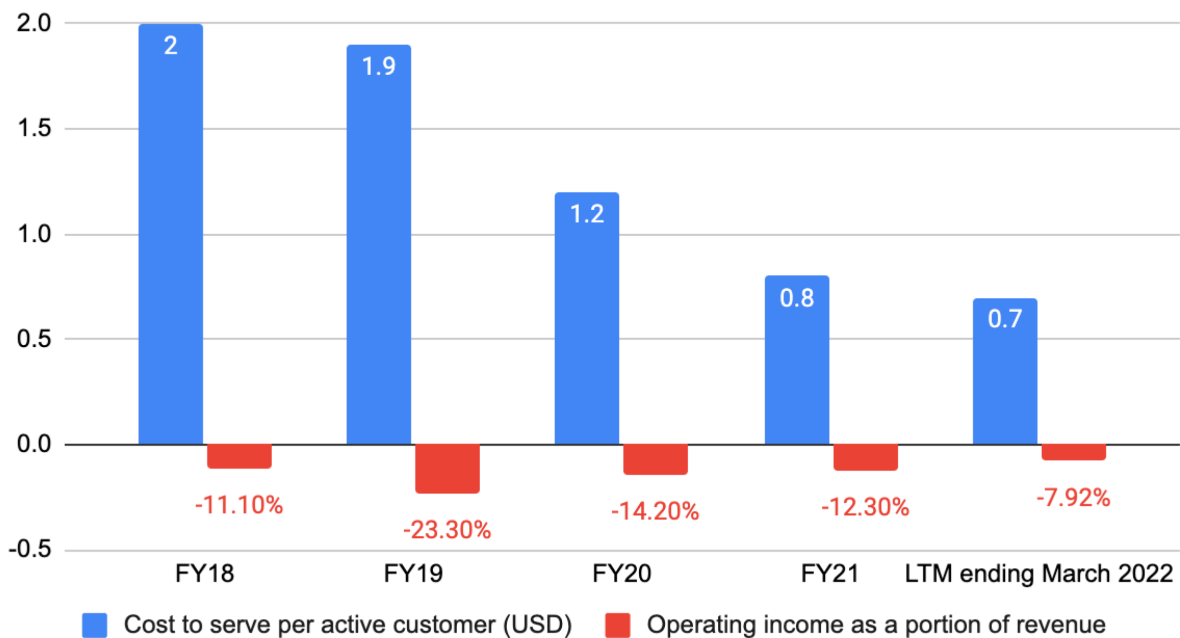

Chart Twenty. Nu operating efficiency. The calculation includes expected credit loss expense [37]

Valuation and Entry Points

We became aware of Nu through our IPO screening in December 2021. Our valuation indicated a conservative fair price at around $7.05 per share with the market price of around $7.04 at that time. We entered positions in the stock at $7.56 on April 17, 2022, and again on May 23, 2022 at $3.73 as shown in chart nineteen below.

[37]Data from Nu annual and quarterly reports.

Nu Stock Price and Entry Point

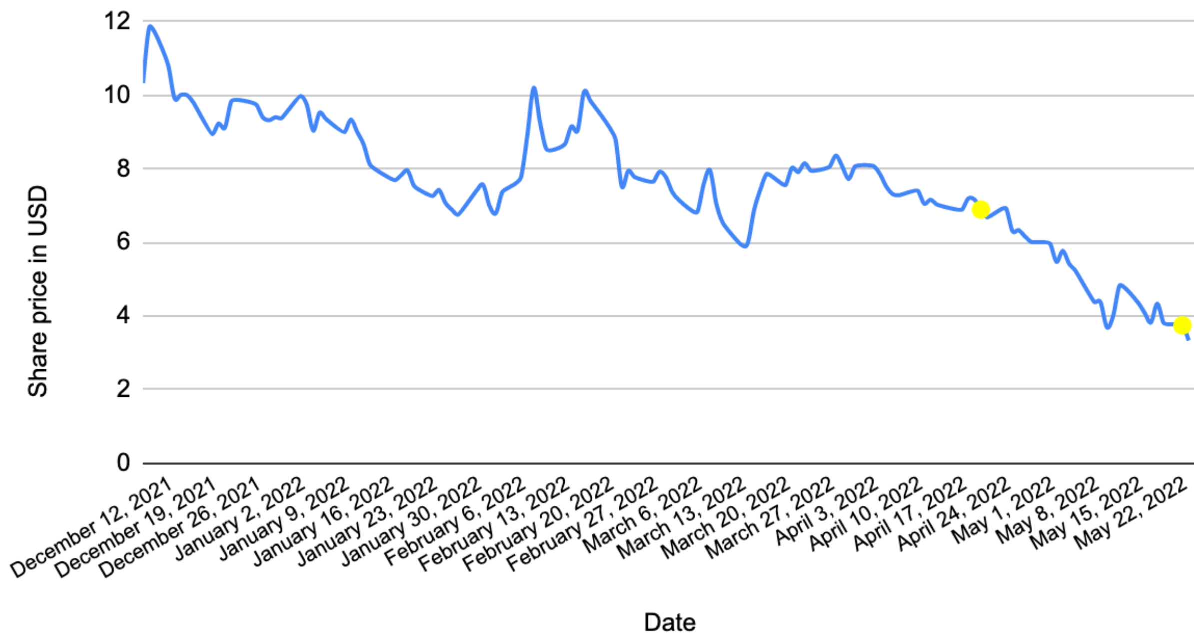

Chart Nineteen. Nu stock price and our entry points

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