INAUGURAL NEWSLETTER

Profeta Global Investments Fund

June 2021

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Introduction to Profeta Investments

After writing many quarterly newsletters over the years, I have the great privilege of writing Profeta Investment's inaugural newsletter. Profeta Investments was established this year in order to invest in quality, growing businesses, when their valuations are attractive. By investing in these types of businesses opportunistically, to ensure a margin of safety between the value of the business and the price we pay for it, investors in the fund should grow their wealth with the growth of the earnings of the businesses we invest in. Our aim is to deliver double-digit returns for our investors over the long term, while minimizing the downside risk. I have a long track record of investing in global securities, achieving double-digit returns per annum for a decade. Profeta will look to continue this performance for many more decades into the future.

Profeta is an old family surname, which dates back to the 15th century, during the time of the Spanish Inquisition. We hope that the fund will live on for as long as the name has. We look to invest in companies which are leaders or emerging leaders in their respective industries. The structure and culture of a business is very important to us and just as Profeta is a founder-run business, we focus on businesses where there is direct alignment with management, shareholders and clients. I have most of my family's net worth in the fund and I like to invest in companies where the management and board have most of their assets invested in the company.

Culture is very important to us when investing in a business. Having grown up in owner-managed businesses and then working in more bureaucratic businesses, with disjointed decision making, it is clear to us that owner-managed businesses tend to innovate quicker, allocate capital more effectively and outperform over the long run. We seek to invest in businesses with consistent and proven management teams. We also look for companies with strong balance sheets as this reduces the risk profile of the business and reflects prudence in the management team.

Profeta Investments has been set up to take a long-term view on investments and to generate superior absolute returns for investors over the medium to long term. Sadly, the funds management industry has been overwhelmed with short term targets and funds have been forced to fit into boxes. Benchmarks have started to dictate how funds are managed. Profeta prefers to go back to basics and focus on purely making money for our clients. We have been investing in global markets for a number of decades and know how global returns reflect a combination of the returns that are generated from the underlying securities as well as the currencies that these securities trade in. We will look to manage both these variables for our clients in order to protect the downside and maximise the upside.

PROFETA INVESTMENTS

How will we position the portfolio for the 2020s and beyond?

We will continue with the same investment approach that we have used for the past two decades, which has proven fruitful. We will buy growing businesses with strong free cashflow and aligned management teams when their valuations are attractive.

In the month of May, Profeta has slowly been setting up the portfolio with companies that we believe will grow their earnings substantially over the next decade, whilst still trading at prices below their intrinsic value.

We have invested in eleven companies around the world, nine of which are founder-led, where the management and board own a significant proportion of the company and are aligned with shareholders.

The Evolution of Healthcare

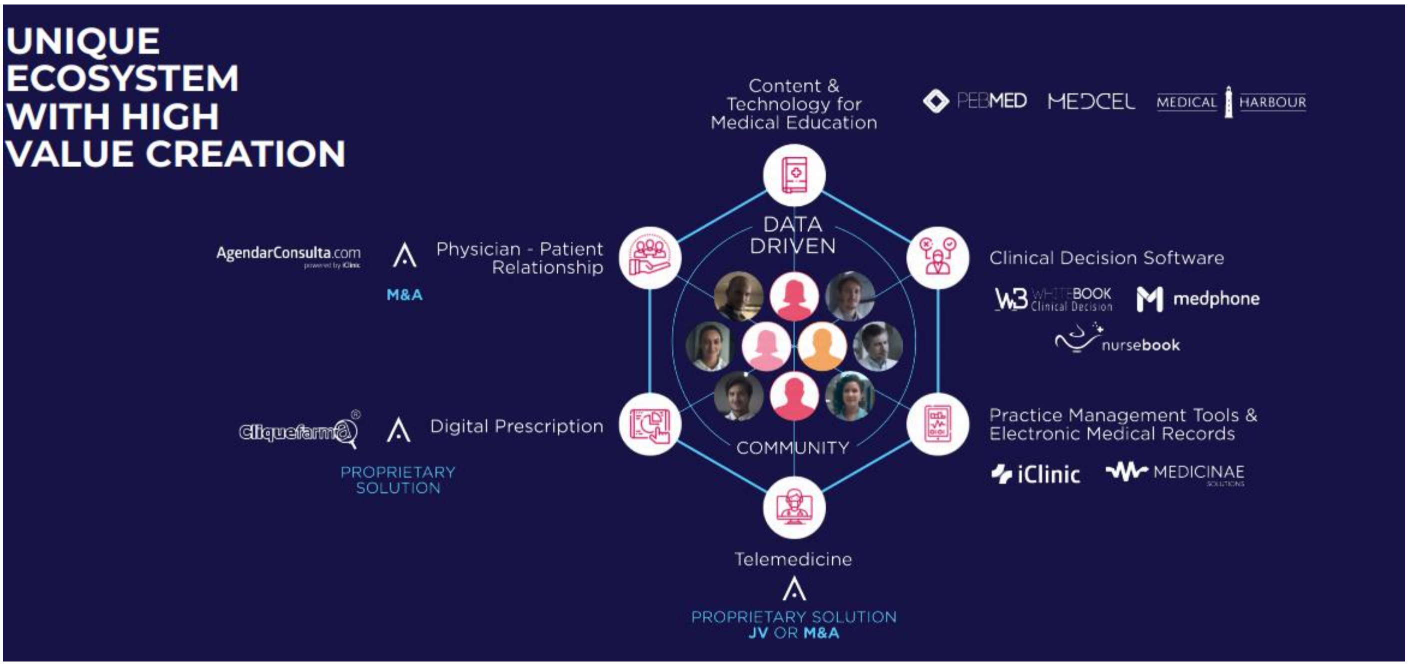
We have seen ten years of progress in the past year with the advent of virtual medicine. We have seen increasing usage of sensor-based technologies that can provide information to physicians. Physicians can now use telemedicine, which takes costs out, whilst still providing the patient with more convenience. Neurologists are using deep brain stimulation, using a brain pacemaker which delivers electricity to treat diseases such as Parkinson's. The Abbott virtual clinic allows doctors to deliver a digital prescription instantaneously on a virtual platform. Not only can doctors diagnose remotely but they can also treat their patients remotely.

We have made an investment in Afya, which is a medical education and technology leader in Brazil. Afya is an owner-managed business with the Chairman, Nicolau Esteves, and the board owning over 50% of the company. Nicolau is a qualified orthopedist and has over twenty-five years' experience in the education industry.

Afya is the leader in private medical education in Brazil with 8% market share of medical seats. They are winning market share and expect to get to 15% market share by 2026. There is an undersupply of doctors in Brazil with only two doctors per 1000 inhabitants versus the OECD average of 3.4. The undersupply is even more accentuated in the north of the country where 90% of cities have less than 1 physician per 10,000 inhabitants. Afya has a strong presence in northern Brazil and expect medical graduates to grow at a rate of 14% per annum to 2026. We expect revenues for the education business to be driven by growth in graduates as well as consistent increases in prices of 4.5% per annum. Physicians in Brazil currently earn twice as much as engineers and four times as much as lawyers, driving the growth in graduates.

Afya is also evolving into the leading medical technology company in Brazil as they have expanded into delivering content and software to both medical students as well as physicians. They currently provide technology to 32% of Brazil's physicians and medical students. Through a combination of acquisitions and organic growth, Afya has created a unique integrated technology ecosystem under a number of brands. iClinic is the number one SAAS provider for physicians in Brazil, providing practice management tools and electronic medical records. Their products focus on telemedicine, revenue cycle management, customer relationship management and marketing. They provided an end-to-end automated platform which digitalises all processes in the clinic. Whitebook provides clinical decision software with hundreds of tools including clinical scores, calculators and medical codes. It has 100,000 monthly active subscribers. Pebmed is the largest portal for news and updates in healthcare with three million visitors per month in Brazil.

We are very excited about our investment in Afya and can see why Softbank has recently invested in the company and will join the board. Afya has grown its EBITDA at a CAGR of 118% p.a. over the past two years, despite the COVID pandemic. The market expects EBITDA to grow at 66% this year. Despite these growth rates, it only trades on a PE of 17x next year's earnings. M3 is a similar type of business in Japan and currently trades on a PE of 95x.



Payments, Commerce and Virtual Reality

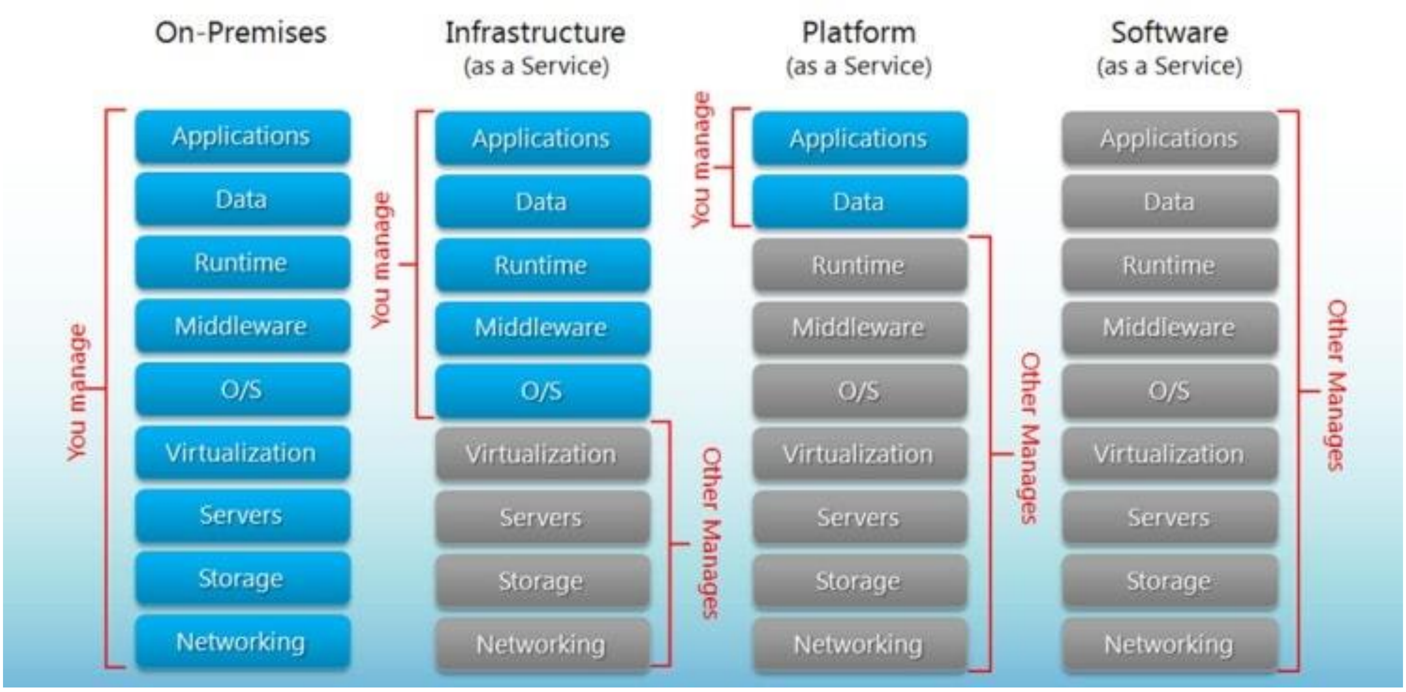
The world is evolving and with it there will be changes to the financial industry as people prefer instantaneous settlement of transactions. Whether this will also involve the advent of new currencies in commerce or whether these new cryptocurrencies will purely be used as a store of value remains to be seen. For a digital currency to be used in commerce, it requires a currency that is not volatile so that merchants will be willing to accept it. We are watching Facebook's launch of Diem in 2021 with intrigue. They aim to launch the Diem as the single US dollar stablecoin with 26 corporate firms. The group will introduce a blockchain digital payment system that will permit real-time ecommerce transactions with Diem stable coins.

We were fortunate enough to attend a virtual conference on the future of everything. Facebook's chief technology officer, Mike Schroepfer gave some interesting insights on their developments, including some upbeat commentary around augmented reality and virtual reality. Facebook's Quest 2, a virtual reality headset, is performing better than expected after they launched it in a wireless form factor. The use cases will slowly move away from gaming to include areas like fitness as well as commerce, so you will feel like you are entering retail stores and looking at different products. Virtual reality will also enhance the social aspects of working from home so that companies can still foster a collaborative environment, bringing together colleagues from different cities and countries. While virtual reality will be the laptop on your desk that you use at home, augmented reality will be the mobile that you take around with you, enabling people to have powerful computing intelligence wherever they go.

While we have invested in Facebook, we are also looking at an intriguing payments company in the emerging markets. Stay tuned for our next newsletter, where we will elaborate more.

Cloud based technology and storage

Data and workloads will continue to be migrated to the cloud and we expect strong growth rates globally. There are three ways that companies are migrating their workloads to the cloud. Infrastructure as a service (IaaS) enables companies to pay as you go for services such as storage, networking and virtualisation. Platform as a service (PaaS) is where a PaaS provider hosts the hardware and software on its own infrastructure and delivers tools that are used to develop applications in the cloud. Software as a service (SaaS) is software provided by a third party in the cloud. SaaS accounts for approximately 24% of all enterprise workloads, while PaaS accounts for 32% and Iaas accounts for about 12%.



We have invested in Dropbox in the US and Baidu in China as a way of getting exposure to this trend. Dropbox has a wonderful SaaS offering while Baidu has a leading PaaS offering in China. We expect these companies to appreciate along the same way that Windows Azure has driven the appreciation of Microsoft over the past decade and AWS has driven the value appreciaton of Amazon. These businesses are owner-managed and are quality businesses trading at surprisingly cheap valuations.

Dropbox

Dropbox is a leading cloud storage and collaboration software company with 700 million registered users and 16 million paying customers. It was founded in 2007 by Drew Houston, the chairman and CEO, who still currently owns 25% of the company.

Dropbox uses an open ecosystem allowing for a wide variety of devices, tools and platforms. Their custom-built infrastructure offers numerous layers of protection. Its ease of use and initially free offering has led to viral adoption with millions of users added each year.

Sales have grown at a 26% compound annual growth rate over the past five years and earnings are expected to grow at over 30% this year. We expect sales and earnings to continue to grow at a healthy rate, driven by increased conversion of their current user base to paying users and increased adoption of some of their newer products. HelloSign is growing quickly with the company seeing a 70% increase in the number of e-signature requests in the past year. They recently added 21 additional languages where HelloSign is available. Dropbox has also recently developed a partnership with Zoom whereby Zoom users can store their meeting notes and a transcript of their calls into Dropbox.

Given the quality of the business, we are surprised at the free cashflow yield that the business trades on. The business currently generates $700 million in free cashflow and is expected to get to $1 billion in three years' time. It currently only trades on an enterprise value of $10 billion and the board are prudently buying back shares.

Baidu

Baidu feels like Google ten years ago, when you had a leading search engine growing its earnings at double-digit rates, building out other businesses that were not being valued by the market. At that stage Youtube was not really earning much and they were still building out their other bets. Baidu is the leading search engine in China and has 558 million monthly active users on Baidu App. Baidu controls Iqiyi, an internet video streaming service, which has over 100 million paying subscribers. It is also investing heavily in artificial intelligence, cloud services and their driverless car platform, Apollo. These businesses are a 15% drag on earnings but we think will become extremely valuable over the next decade. If you apply a 12x PE multiple on 2022 earnings to the search engine (half the multiple of Alphabet's Google) and take the value of their stake in Iqiyi, which is listed, you get to the current share price. This means that you are getting their artificial intelligence, cloud, autonomous driving car platform (Apollo) and stake in Trip.com for free. We think attributing a value to these businesses gives you a valuation twice the current share price, which is close to where the stock was trading at in February.

Baidu has been investing in their artificial intelligence (AI) and cloud products for many years now. Last year they spent US$3 billion in research and development for AI, which is used for their cloud services as well as autonomous driving. Their Baidu EasyDL, is a machine learning service that was rated number one in China in terms of usage. PaddlePaddle, is the first open-source deep learning platform in China and is being used by more than two million developers and 85,000 enterprises globally. It is being used in a variety of industries with applications such as garbage sorting robots to pneumonia CT image analysis, enabling a Beijing based company to develop an AI powered pneumonia screening system. Banks are using Baidu's AI PaaS to automate customer service and consumer loan approvals, while China's CCTV is using it to automate video clips and locate video content.

While the market has been excited with electric vehicles, which I believe will just become the new normal and the battle will continue to be a battle of brands, the real revolution is in autonomous driving. Baidu has been investing in their Apollo autonomous driving platform since 2013. In 2017 they started mass production of the Apolong bus with level 4 autonomous driving capabilities. Apollo currently has permits to pilot fully autonomous driving in Beijing, Cangzhou and Chagsha and Chongqing signed with Apollo to make its smart transportation infrastructure 5G enabled to support robotaxis.

I was fortunate enough to go to BMW's innovation centre in Munich and spent several hours learning about the difficulties of getting cars to level 4 autonomous driving and establishing robo taxis. BMW said that they expect this to occur in 2025. They said that it was easier to have autonomous cars in cities with grid like streets. That is why most of the successful testing has occurred in Las Vegas, in the US. You require more artificial intelligence in rural areas as there are more variables that occur, such as fallen trees or snow. Beijing is actually well set out for automonous cars and it looks like it will be the first global city to have driverless robotaxis, thanks to Baidu's Apollo. They are launching their services this month in Beijing, which will be China's first paid autonomous vehicle service. The Apollo Go Robotaxi service is being launched in Beijing's Shougang Park, one of the venues for the 2022 Beijing Winter Olympics. The total addressable market for robotaxi ride hailing is expected to reach US$224 billion in China by 2025.

Apollo Go Robotaxi

Launched in Beijing's Shougang Park, one of the venues for the 2022 Beijing Winter Olympics

Music streaming

Vivendi's Universal Music Group

Vivendi is a leading media and music content company based in France. It is run by the Bollore Family, who own 27% of the company, with Yannik Bollore acting as the Chairman of Vivendi. Vivendi owns a number of media companies in France which include Canal Plus and Havas. However, the jewel in their crown is Universal Music Group (UMG), a business that they have owned since the early 2000s.

Universal Music Group (UMG) is the world leader in recorded music revenue with 32% market share. They are a music content leader as a music label and publisher with a vast catalogue of songs that go back a century. Their catalogue includes The Beatles, Taylor Swift, Justin Bieber, Rhianna and ABBA to name a few. While Spotify is still not profitable and is valued at $42 billion, UMG is expected to earn an EBITDA of $1.5 billion this year. For every $100 of revenue that is generated on Spotify, the label and publisher get $65 and Spotify only keeps $35. Music streaming revenue has been growing at over 20% p.a over the past five years and is expected to growth at a 15% compounded annual growth rate over the next five years as streaming services grow around the world. This will drive UMG's growth into the future. We think Vivendi is undervalued and the catalyst will be spinning out UMG into a separately listed company at the end of this year.

UNIVERSAL

UNIVERSAL MUSIC GROUP

vivendi

A look through the decades

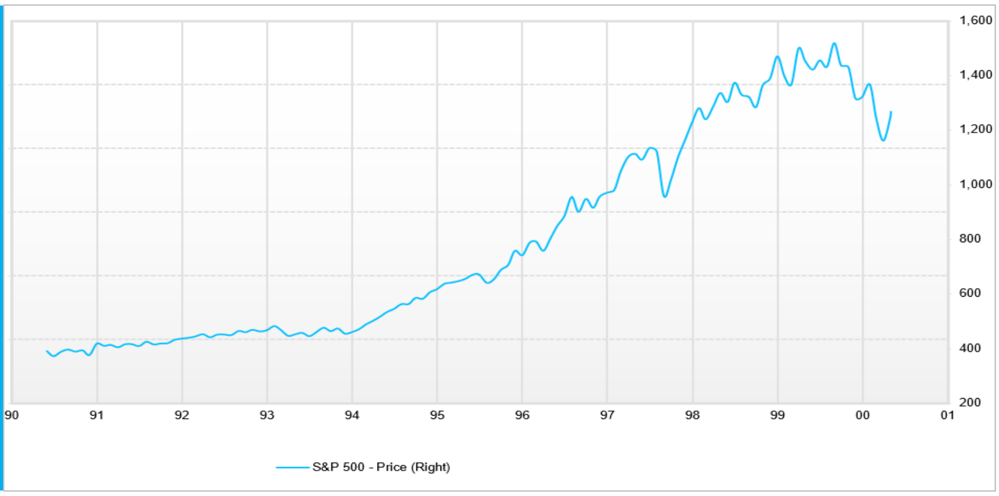
A wise portfolio manager once told me that he thinks in decades. Usually, each decade is different with different investment trends and opportunities. It is interesting to note that while each decade comes with changing consumer behaviours and patterns, and developing innovations, the performance of the stock market is not a mirror image of these developments.

1991-2001

The 1990s were a period of economic boom. In the United States, an economic expansion began after the end of the early 1990s recession in March 1991 and ended in March 2001 with the start of the early 2000s recession, during the Dot-com bubble crash (2000–2002). It was the longest recorded economic expansion in the history of the United States until July 2019. The stock market tripled over this decade as the internet started to change the way individuals and businesses operated and improved productivity.

Research at CERN in Switzerland by British computer scientist Tim Berners-Lee in 1989–90 resulted in the World Wide Web. The Internet's takeover of the global communication landscape was rapid in historical terms. It only communicated 1% of the information flowing through two-way telecommunications networks in the year 1993, 51% by 2000, and more than 97% of the telecommunicated information by 2007. From the mid-1990s, the Internet had a revolutionary impact on culture, commerce, and technology, including the rise of near-instant communication by electronic mail, instant messaging and video chat. From there social networking service and online shopping sites emerged.

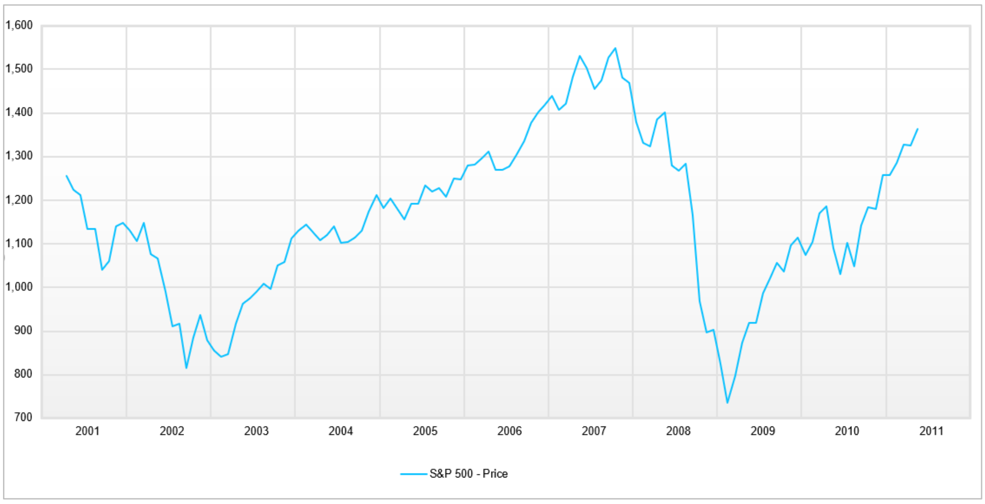
S&P 500 1991 to 2001



2001 to 2011

While economies and businesses evolved and took advantage of the internet, the US stock market did not appreciate for a decade. Economic growth continued at a healthy pace until 2008. The housing market in the US boomed and creative financial products engineered by banks led to a global financial crisis as the banking system withdrew liquidity from financial markets.

S&P 500 2001 to 2011



2011 to 2021

This period had the longest bull market in stocks in history, which began in March 2009. Low interest rates supported most industries and the technology sector thrived in a period where online advertising and e-commerce continued to take market share from traditional businesses in retail and advertising. Software businesses thrived and we saw a shift of data and services into the cloud. The top five companies all became technology companies with market capitalisations surpassing $1 trillion dollars each and now comprise over 20% of the total index. We saw the emergence of plant-based meats and cryptocurrencies and the view that Tesla will takeover the auto market.

In 2020 we were hit with a global pandemic and central banks and governments decided to flood the world with liquidity. There was a 26% year-over-year increase in M2 money supply, the largest gain since 1943, as fiscal spending in response to the pandemic has topped $5 trillion in the US. M1, or very liquid money in circulation, is up by 316%. The Federal Reserve began purchasing $120 billion per month of Treasuries and mortgage-backed securities and it is yet to wind back this quantitative easing. Central banks in Europe, Asia and Australia have also followed suit with quantitative easing and money printing and governments have supported economies with helicopter money and fiscal stimulus.

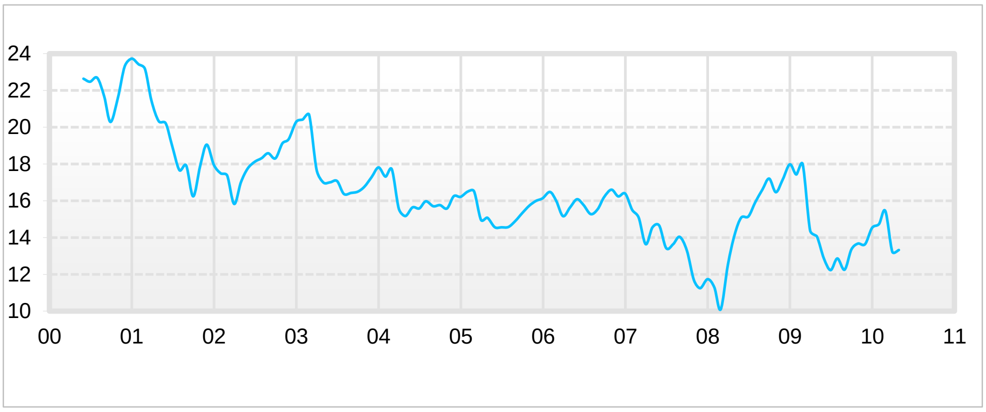
As can be seen below, all these factors have driven the S&P500 up threefold over the past decade.

S&P 500 2011 to 2021

Do all markets behave the same way every decade?

Now what if I asked you how do you think the US market will perform over the next decade, starting from the current level at the current decade high PE multiple of 22x? In 2001, when we were at these levels, the US market had a lost decade with no capital appreciation for a decade as the multiple de-rated.

S&P 500 PE FY1

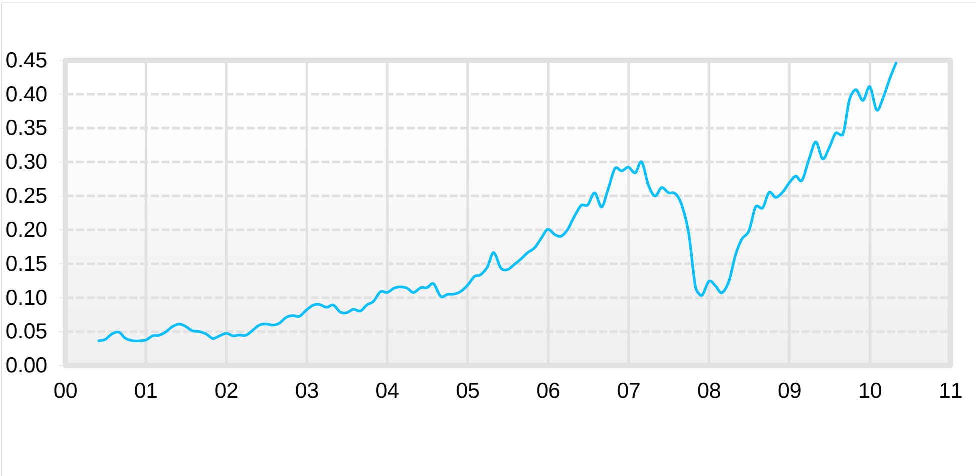


If you look at the US market, our starting point is similar to 2001. We are seeing excesses with SPACs and a new dogecoin emerging every day with a $2.3 trillion global crypto market.

S&P 500 PE FY1

So do you just keep investing in the same expensive stocks or do you search the world for undervalued gems? Just to give you some perspective on how different global markets behave during different periods, you can see the performance of Indonesia's JSX index from 2001 to 2011 in US dollars below. Over this decade, Indonesia's index was up 9x compared to the US's S&P500 which was flat.

Indonesia JSX - Price



Over the past decade however, while the US index has soared and has tripled in value, the Indonesian market has been flat.

Indonesia JSX - Price

What this highlights is that different industries perform differently over decades, as each geography has a different skew to certain industries. Indonesia has a large exposure to the finance, manufacturing and mining sectors, whereas the US has a large dependence on technology, healthcare and consumer discretionary sectors. It also highlights that the valuation you pay for an asset today will dictate the returns you generate over the long term.

Index and ETF investing

There is an argument in financial markets that you should just buy an index, rather than worrying about active management. But which index do you buy? Do you realise that currency moves have just as big an impact on your performance as the share price moves? Do you know what valuations you are paying for the underlying securities that make up that index or ETF? Do you know what currencies you are exposed to? As an active manager, these are the considerations we think about every time we buy a security.

Watch out for inflation!

I have been speaking to business owners and hearing many gripes about how hard it is to find labour now as we enter the recovery period of this covid era. Hospitality businesses are finding it hard to find employees as students and travellers have gone back to their countries of origin. Developers and construction businesses are finding it hard to keep up with the boom in their industries and many people on minimum wage in the US prefer to collect their handouts than go back to work. Then you add on the significant increase in commodity prices from iron ore to copper and corn and supply chain shocks in logistics and it is no wonder that Warren Buffett called out inflation at the recent Berkshire Hathaway annual general meeting.

The chairman of Nebraska Furniture Mart, said that the price of one shipping container has jumped over the past six months to $10,000 from $3,500 saying, “It’s the highest rate of inflation I’ve ever seen, except for in the 70s.” Walmart’s finance chief, Mr Biggs said that so many businesses are hiring at once to meet demand that this is leading to hot spots in certain markets. Macy’s also mentioned that the tightening job market has led to a higher level of open positions.

It is no wonder that the recent consumer price index showed that prices increased by 4% in April in the US, the fastest increase since 1981. There are currently chip shortages, which could lead to price rises in televisions, ipads and cars, where we are seeing supply shortages. The question is, how will central banks deal with this inflation during a period where debt has sky rocketed and government debt to GDP in the US now stands at 127% and households have geared up around the world.

The threat of rising interest rates has led to sharp declines in highly priced companies from Tesla to Afterpay. I think valuations will matter more over the next decade as the free ride many companies have had from liquidity excesses will be different over the next decade.

The 2020s will be a time when companies will have to rely on their own free capital generation to fund their growth and where businesses will once again be valued on their real earnings and free cashflow rather than on how well their CEO can spruik their future growth potential.

Our process relies on buying quality, growing businesses that are valued based on their free cashflow generation. We look for companies with strong balance sheets that do not have to rely on the generosity of capital markets to sustain their business model. I wish everyone a fruitful decade and welcome our new investors into the Profeta Global Investment Fund.

Your sincerely,

GARRY LAURENCE
Chief Investment Officer
Profeta Investments