Somerston Technology Fund (the Fund)

Investment Letter No.3 – September 2021

Portfolio Objectives: To grow capital over the medium term by investing in a concentrated portfolio of high growth companies.

Performance: The Technology Fund fell by -1.6% in the third quarter. The Dow Jones Internet Index fell by -3.6%.

Performance (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	6.1	3.9	4.2	4.5	7.7	-1.5	5.8	3.2	-0.1	8.5	3.8	-0.8	**55.1**
2018	12.3	-1.4	-4.1	1.0	8.0	-0.1	0.0	8.9	-1.8	-12.3	1.3	-7.5	**1.7**
2019	12.0	2.9	5.6	6.3	-8.0	8.2	4.1	-3.8	-1.8	3.1	6.1	3.8	**43.6**
2020	6.2	-3.8	-6.6	18.2	9.6	10.0	9.1	8.5	-6.2	-0.7	9.6	5.5	**73.4**
2021	-0.2	1.6	-6.5	8.8	-3.6	11.6	1.0	5.7	-7.9				**9.2**

Sector Allocation

Sector	**% Portfolio**
Information Technology	62.6%
Communication Services	19.0%
Consumer Discretionary	15.8%
Health Care	0.9%
Cash/Divs/Fees	1.7%

Geographical Allocation

Country	**% Portfolio**
USA	84.7%
Argentina	5.3%
Canada	3.4%
Taiwan	3.4%
Cash/Divs/Fees	1.7%
Israel	1.5%

Top Ten Holdings

Name	**% Portfolio**
Amazon.Com Inc	9.0%
Microsoft Corp	8.7%
Apple Inc	8.7%
Nvidia Corp	7.8%
Alphabet Inc-Cl A	6.5%
Mercadolibre Inc	5.3%
Facebook Inc-Class A	4.9%
Paypal Holdings Inc	4.4%
Square Inc - A	4.0%
Zscaler Inc	3.6%
Total	**62.9%**

This letter shows the performance of Somerson's "Technology Equity Strategy" from 31 December 2014 to 30 November 2020 then the Somerston Technology Fund from its launch on 01 December 2020.

Commentary

In this quarter's report we discuss two of the fund's newest holdings: Datadog and AMD.

Datadog shows how 'expensive' companies can get a lot more expensive; the company illustrates exemplary leadership, and it is a rare example of a challenger 'winning' versus a company with first mover advantage that was more focussed on its sales than the quality of its product.

Datadog went public in September 2019. At the time it was valued at an astonishing 33 x full year sales of $360 million. Since IPO, the stock has appreciated 435%, outperforming the Nasdaq 100 by 345%. This total return has been fuelled by incredible sales growth - full year 2021 sales is expected to be $941 million – a two-year CAGR of 64%. Perhaps more surprisingly, its valuation has risen from the heady 33 x revenue at IPO to 47 x revenues today.

Datadog is both an infrastructure monitoring and network performance software application. Crucially, it distinguishes itself from peers by being totally indifferent to on premise, pure cloud, and hybrid approaches. It monitors code, servers, memory, and applications to ensure that its customers' experience is delivered at consistent high speeds, whether it is on premise, mobile or via virtualisation software.

Gartner forecast cloud spend will rise from $270 billion in 2020 to $661 billion by 2025. Of this, $34 billion is forecast on infrastructure and performance monitoring. Datadog's revenues in 2021 are expected just below $1 billion. There is plenty of room to grow into this total addressable market.

Datadog has shown net retention rates of over 130% for sixteen quarters showing that customers are increasing their spend. Datadog's customers are beginning to consolidate their service providers, which have proliferated along with the growth of the cloud. In their earnings call, management repeatedly spoke of the trend of customers to 'standardise approaches' across applications.

The CEO, Olivier Pomel, started his career as a software engineer and went on to spend time curating product for customers. He has both engineering and product prowess and has a clear and ambitious vision for Datadog. This allowed the company to produce well positioned products that serviced on premise, hybrid and cloud clients when few others did. Splunk was the 'darling' a few years earlier, but they failed to adapt to the hybrid, on premise/cloud era. Splunk's revenue growth slowed, profitability evaporated, and its share price faded.

Datadog trades with a high revenue multiple, but they are in a market that is growing rapidly, they have plenty of market share gains to go after and have two visionary founders with real skin in the game.

AMD's story is somewhat different, but like Datadog, AMD also have great leadership. The company's 'one upmanship' with intel over the years, with repeated price wars, caused AMD's credit to become unstable. Dr Lisa Su took the helm in 2014 and developed an entirely new vision to produce the best products for its client in the highest growth areas of the markets. In 2017, AMD leapfrogged Intel by launching Computer Processor Unit (CPU) chips that were at least two generations ahead of Intel. In close succession AMD launched leading chip solutions to serve gaming, artificial intelligence, and High-Performance computing (HPC). Under Dr Lisa Su's leadership the company has gone from being financially levered to having a significant net cash position. Revenues have grown 266% in the past five years – even better than Nvidia (+232%). But whereas Nvidia is valued at $511 Billion, AMD is valued at $123 Billion for similar levels of revenue. Nvidia is a clear leader in the GPU chip market and deserves a premium valuation but even after the stellar return AMD has delivered, it remains relatively attractively valued. There are obviously fears that Intel comes back at AMD – and that is certainty likely - but 'Moores law', which states that the number of transistors in a dense integrated circuit doubles about every two years [and its price halves], is starting to look unfounded at such density. Now we are down to 7nm chips the ability to double every two years is proving very challenging. Chip demand and specifications are growing exponentially in an age of artificial intelligence, machine learning, Automation etc. So at a time when chip demand has never been so high, the rate of processing improvements appears to be waning, yet chip specification is climbing exponentially, there is hope that significant deflation incumbent in this industry is abating.

AMD has enjoyed a good run, but its leadership team is clearly exceptional, and the fundamentals of the market are strengthening. It balance sheet now allows the company to undertake acquisitions and in 2020 AMD announced a prescient tie up with Xilinx. Together, the combined company will capitalize on opportunities spanning some of the industry's most important growth segments from the data centre to gaming, PCs, communications, automotive, industrial, aerospace and defense.

Contributors:

During the quarter, the largest contributors were Zscaler, Alphabet and Datadog. The largest detractors were Paypal, Twilio and Roku.

Activity:

During the quarter, we acquired Snowflake, UiPath and Advanced Micro Devices. We disposed of Redfin, Stoneco, Coupa, Alibaba and Tencent.

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