



SaltLight Capital Management
Unit 3 Brookwood, 50 Hyde Close, Hyde Park,
Johannesburg, 2196
Telephone: (011) 268-6057
Website: www.saltlight.co.za

SaltLight 2Q21 Letter

2 August 2021

As our fund has been in operation for less than a year. Under current FSCA regulations, we are not allowed to provide any performance disclosure. We are, however, allowed to disclose the following:

SaltLight SNN Worldwide Flexible Fund Class C1	NAV Price
Inception Date – 19/11/2020	999.17
March Quarter – 31/3/2021	1145.74
June Quarter – 30/06/2021	1218.13

Dear Co-Investor

The second quarter of 2021 would probably rank as the most ‘reflationary’ economic environment that we’ve seen in decades.

We’ve utilised this buoyancy to reposition the portfolio outside of South Africa and into global opportunity sets that we’ve been working on over the last few years.

Much of our capital reallocation was deployed in increasing positions in US technology (Facebook and Twitter) as well as further deployment to Alibaba in China.

Many investors would roll their eyes at a Facebook investment (see our thesis below) and raise their eyebrows with Twitter. However, as it often happens, we find investments ideas because we are looking at some other opportunities and we discover an insight that leads us to something meaningfully better.

It is our tepid notion that “*curiosity*” is a key input in our investment process, however, over the years, it has sourced wonderful ideas for us. As Richard Feynman said: “*Study hard what interests you the most in the most undisciplined, irreverent and original manner possible*”

- We discovered Cartrack because of discussions we had with Transaction Capital management. Cartrack was providing all the telematics devices that powered the information advantage that SA Taxi had in establishing better loan pricing for taxi operators.
- A poorly attended AGM (3 pm on a Friday??) for a large bank that we joined, led to an investment in Purple Group (popularly known as “Easy Equities”). At the meeting, they casually announced that they had just signed a partnership to provide Easy Equities to their 9m clients. The best thing of all, Easy would pay nothing to acquire these new customers.
- Research on Tencent’s gaming business took us to game engines that led us to NVIDIA. As we studied NVIDIA, we learned about their developing AI business and how GPUs were powering this field.

- GPUs led us to the semiconductor sector and forced us to ask questions about technology bottlenecks for scaled AI. Research work here led to insights into the hardware and software necessary to solve many AI problems.

So much of our industry is coalescing around hyper-specialisation. In our early years, we made a similar mistake in focusing on one country to invest in. Our evolution has led us to rather focus on certain business models rather than sectors, countries, or asset classes. This has given us the space to pull on many threads.

We are intentional about actively “exploring” new products, new software, and new technologies. To name a few off-beat paths of recent “research”, we’ve tinkered with building two games to test different platforms (boy there is a skill to creating an engaging game!), playing with conversational multi-lingual AI models and spinning up cloud servers to test network security software.

Of course, only a few of these loose threads that we’re pulling on will likely turn into portfolio investments for our fund, but we value the learning that we get from being generalists.

*(In building our *games* we discovered how far the nascent building blocks of VR have been laid already – see what it led to below)*

We value the same principles of adaptability, experimentation and ‘fail fast’ in our portfolio companies. Ideally, we hope that this process will destroy our preconceived ideas; be adaptable to new opportunities and most of all, help us be learning machines.

Facebook

“I hide in plain sight” – Gustavo Fring, Mastermind, Chicken Franchise Owner – Breaking Bad series

At SaltLight, we’re giddy with excitement when we uncover businesses that the market has not “discovered” yet. Our composure also weakens when we find a business that is ‘hiding in plain sight’ and market participants are underestimating the duration of a moat or under-appreciating a strategic shift into a new business (our heart skipped a beat with *Transaction Capital’s recent acquisition of WeBuyCars*).

Whilst an investment in Facebook is unlikely to win awards for being original, we must remind ourselves that our job is to find **durable** and **indispensable** businesses that have great odds in creating long term returns for investors who trust us with their hard-earned capital. We cannot think of a better company than Facebook.

Our incongruous path to working on Facebook came after exploring Southeast Asian and Japanese B2C companies (*a story for another day*). In discussions with these businesses, the common challenge confronting them is acquiring new customers (particularly during the COVID period). Facebook and Google kept coming up as the most effective way for targeting new customers. This spicy insight was the indispensability that we were looking for.

The share price was unreconcilable to the implied value over the next 3–5 years and, optionality that exists with new initiatives. The decision to deploy capital became rather easy.

Critics will argue that Facebook has a deep market penetration already (almost half the world's population of 3.5bn monthly active users across Facebook, Instagram and WhatsApp) and an obvious question to ask is - *how much juice is left?*

Our view is that the growth of users is less important; monetising the strong network effects across its platforms and the balancing act of capturing value vs. facilitating value is the more important question for future returns.

Our broad thesis rests on (1) moving down the transaction stack, (2) monetising WhatsApp, (3) enhancing discovery and (4) the optionality around the “next consumer platform”.

Regulatory challenges will always be a potential headwind. The impact of Apple's changes to IOS (App Tracking Transparency) is still unknown. However, the question to also ask is: what's in the price. Our letter is on what we think is not in the price.

The Advertising Engine

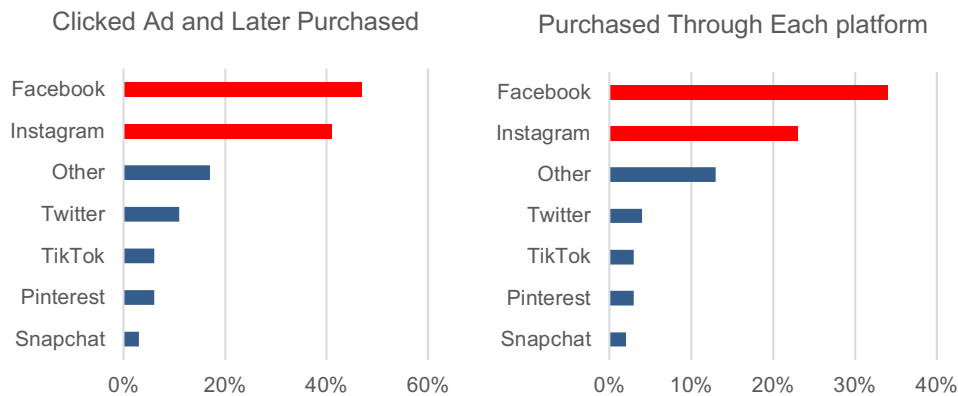
First, it is helpful to give a brief overview of the current profit engine. Digital advertising has essentially democratised ad buying – from blue chips right down to SMEs and increased the surface area of targeting high-propensity-to-buy customers. The true genius of the online advertising model is:

- **Long-tail of potential customers:** The potential ad inventory is so much larger (e.g., women in their 20s within a 10km radius who are away from home) than the inventory from a print magazine or TV commercial slot (e.g. the ten LSM categories¹)
- **Quantitative measurement of ROI:** Advertisers can measure the performance of ad spend at a very granular level vs. the ‘spend and pray’ approach to traditional advertising.

Facebook makes it simple and affordable to reach customers that a business truly wants. Much of Facebook's revenue comes from direct response advertising such as joining a list, buying a product, visiting a store, or installing an app.

¹ The South African Advertising Research Foundation had 10 Living Standard Measure categories in which to categorise advertising targeting

Their advertising distribution base (from blue-chip companies to SMEs) combined with advanced algorithms fed with data from 3.5 bn users creates an incredibly durable moat. This 2020 survey² demonstrates how effective social commerce on Facebook is compared to other platforms. Despite its rapid adoption, TikTok still trails behind Facebook platforms considerably.



Moving down the transaction stack

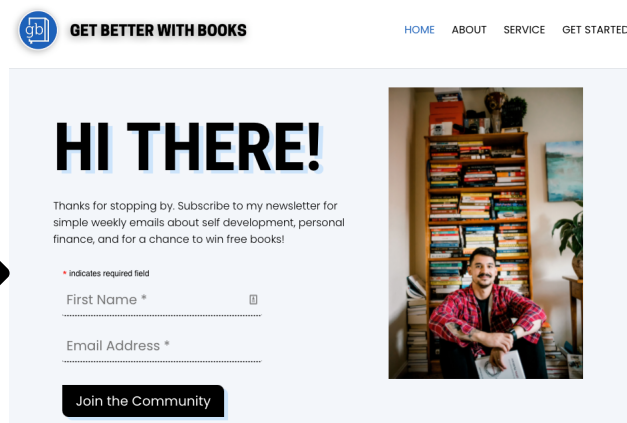


Figure 1 - Ad appearing in our Instagram Feed

Figure 2 - Follow-on website when clicking on the Ad

Readers will recall that, across its platforms, Facebook shows a targeted ad (figure 1 show that their ad targeting is impeccably tuned to our interests), and the user clicks the ad to which they jump onto another site.

² Source: <https://couponfollow.com/research/shopping-through-social>

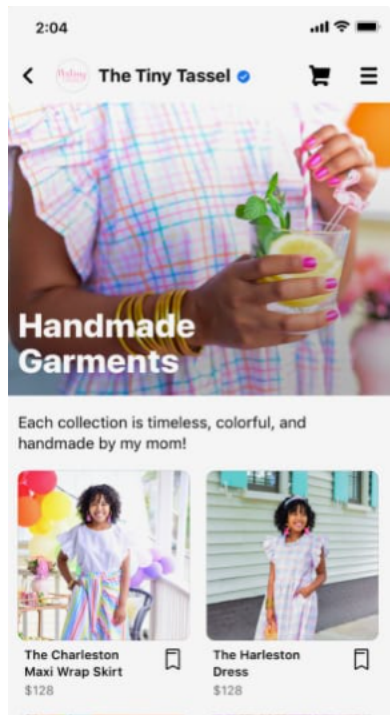


Figure 3 Instagram Shops Example
(source: Company)

Once on the seller's site, the user's experience varies greatly and is highly dependent on the seller's technical sophistication. For SME's, this is not their core competence. And for buyers, painfully, they need to keep entering their credit card details for each new website (with the associated risk of fraud with each new entry)

Over the last year, management has been strategically developing products to move up (discovery) and down (checkout and payments) the eCommerce stack.

In 2020, Instagram shops were launched where a user can purchase directly via an Instagram account.

The only part of the transaction left for the merchant is shipping.

These features have taken off considerably in one year. As of June 2021, they already had 300 million monthly Shops visitors and over 1.2 million monthly active Shops³.

Monetising WhatsApp

Our thesis over the next few years is that WhatsApp will be increasingly monetised (Zuckerberg is playing the long game after buying it back in 2014!) and will be an integral part of the Facebook/Instagram shopping architecture.

At this stage, WhatsApp is virtually unmonetised and therefore is not meaningfully appearing in the income statement (and valuation multiples).

Since we have invested, the pace of monetisation of WhatsApp is gaining steam.

- Consumer to business interactions over chat.
- Payments from WhatsApp are already available in Brazil and India.
- Shopping directly on WhatsApp

³ Source: <https://about.fb.com/news/2021/06/new-ways-to-shop-for-products-you-love-across-our-apps/>

Monetisation here is likely to still be predominantly ad revenue, however, management is disclosing a 5% take rate on GMV⁴ on its Facebook marketplace and shops products. This is likely to carry across to the WhatsApp store.

Discovery

In the abundance of choice, ‘discovery’ is a key weapon in the War of Attention. The scarcest resource in the internet era is time. The modern “end-game” objective of consumer platforms is to maximise attention and engagement. If a user’s attention is on your app, they’re not spending time (or money) on another.

Social networks (Instagram average daily time: 28 mins⁵ and Facebook: 38 mins⁶) over the last decade have been about showing what your network connections are up to and keep users engaged with this content. However, over the last two years, engagement has moved to the discovery of new content. AI recommendation algorithms are dynamically trained with user data to ‘hone’ in on what the users want to see outside of their network.

The scary part is that these algorithms don’t need a lot of explicit data. They only need an hour or two’s worth of usage to understand each user’s personal interest graph. From here, they can surface the content to keep up engagement.

The implication here is that discovery-enabled engagement needs content, and this comes from creators who can ‘monetise’ their time and effort. Of course, there will always be those who create content for social capital and nothing else. But for successful creators, social media can be a front end for an entire business. Here is JoJo Siwa (18 years old and 10m Instagram followers) selling her new collectable figures (video [here](#)).



Figure 4 - JoJo Siwa (source: [Instagram](#))

⁴ GMV is Gross Merchandise Value which is essentially the value of spend going through the Facebook on-platform tills. Note: Facebook has waived fees until June 2022 as a Covid relief measure

⁵ Source: Techjury.net [link](#)

⁶ Source: Techjury.net [link](#)

Creators are a wonderful source of social “nudges” to enhance propensity to buy but also introduce new products. Over the years, we have had some admiration for the Chinese consumer apps that have enabled influencers to flourish.

Influencers (or Key Opinion Leaders in China) offer a ‘live stream’ where they talk to fans about products that like (sort of like a home-shopping show). This is not a niche business; in 2021, \$61bn of GMV transacted on Alibaba livestreams alone. To get a sense of where Facebook could be heading, you can watch this intro video [here](#).



Figure 5 - Taobao Live from Alibaba

These new product roadmap areas will take some time to develop. However, with Facebook’s advertising base, users, and the attractive benefits of network effects, we think there is a good chance that Facebook will be very successful.

Next Consumer Platform

Look further ahead from the current social platform, there is considerable optionality in the Facebook Reality Labs business.

Oculus is the virtual reality (VR) and augmented reality (AR) (collectively called XR) platform and primary product in this division.

Is Virtual Reality a fad? Facebook management doesn’t believe it is and they’re investing heavily in this initiative with 10,000 employees currently working in the division and R&D capital expenditure estimates of \$3-4bn a year being redeployed from digital ads profits.

Mark Zuckerberg believes the VR technology is a key component of a sci-fi idea called the *Metaverse*:

In the 2Q21 Earnings Call, he described the Metaverse as this:

*“So, what is the metaverse? It's a virtual environment. We can be present with people in digital spaces. And you can kind of think about this **as an embodied Internet that you're inside of rather than just looking at***

And we believe that this is going to be the successor to the mobile Internet. You're going to be able to access the metaverse from all different devices and different levels of fidelity from apps on phones and PCs to immersive virtual and augmented reality devices. Within the metaverse, you're going to be able to hang out, play games with friends, work, create and more” (emphasis ours)

Our thinking is that this is not far-fetched. But we’re currently constrained by technology. Two years ago, it would have been inconceivable that white-collar jobs could be functional over 2D video conferencing. However, if you’re like us, we’re finding that video conferencing is not an adequate substitute for in-person meetings given that we’re only using two of our senses.

Secondly, we’re slowly moving into these virtual worlds. Anecdotally, we can share that this author jumps into a virtual world every weekday on an app called Zwift (cost \$14.99 pm); connecting a real-world exercise bike and riding a virtual race with thousands of other live participants on an island called Watopia (*oh! the hills are no less painful*). An ‘embodied’ version of VR would enhance the experience incredibly.

VR and AR technology is certainly nascent and still has many technical shortcomings⁷ but ultimately as with all new technology products, early versions of products are clunky, impractical to use and quickly dismissed⁸.

In 2018, management estimated that it will require 10m users on a new consumer platform to sustain an ecosystem (content developers and hardware development) that creates the positive feedback loops necessary for wider adoption. This kind of installed base is not far away. In Q4 of 2020 alone, Facebook sold 1m Oculus Quest 2 VR devices⁹. The Quest 2 devices were technology breakthroughs because they’re the first to be untethered from PCs and can operate on a standalone basis.

Similarly, to the development of mobile phone apps, games are the first early-adopter products. There have also been some interesting use cases now that the devices don’t require to be attached to a PC.

This video [here](#) shows the first breakthrough VR product called Beat Saber. The game digitises music beats by creating blocks that the user needs to slash with Star Wars-like Lightsabers. It certainly is a wonderful Generation Z workout product!

⁷ (1) A common side effect is VR motion sickness, (2) low resolution and refresh rates

⁸ The 1985 Vodafone VT1 weighed 4.7kg and only offered 30mins talk time before needing to be charged for 10 hours, [source](#).

⁹ Facebook doesn’t directly disclose Oculus sales, but their LTM revenue from ‘Other’ is already at \$2.3bn



Figure 6 - Beat Saber by Naysy (Source: [YouTube](https://www.youtube.com/watch?v=81294811110))

How Big could the “Next Consumer Platform” be?

This is always hard to estimate. We’re in the year 1910 trying to estimate how many vehicles Henry Ford will sell. But early adopters are likely to be gamers and remote workers. There is an installed base of 1.1bn game consoles, 300m daily meetings held on Zoom¹⁰ and 250m active users on Microsoft Teams¹¹.

The price is also not as expensive as one might think. The Oculus Quest 2 is selling at \$299. Facebook is subsidising the hardware at an affordable price point to grow adoption and yet it is a third of the cost of a new iPhone 12 and 12% cheaper than a Sony PS5.

Oculus is in a good position. Whilst it is in the back of our minds that the mobile phone era was not won by the first mover, i.e., Blackberry or Nokia but in terms of current data, Oculus has the dominant 49% market share in games with the next competitor coming in at 17%¹² market share.

The Right Question

Our investment framework asks the question: what kind of predictions does the current share price force us to make?

We believe that the current opportunities do not require bold odds or lofty returns to make sense. Since making our first investment, Facebook has crossed the 1 Trillion Dollar market capitalisation mark. We believe that IF our thesis plays out: (1) moving down the transaction stack, (2) monetising WhatsApp, (3) enhancing discovery and

¹⁰ Zoom Analyst Call, 2Q21

¹¹ Microsoft 4Q21 Analyst Call

¹² Source: Steam [link](https://store.steampowered.com/sales/2021/)



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(4) the optionality around the “next consumer platform; the company should get to the next Trillion in the next few years.

As always, please feel free to get in touch with us should you have any questions. We always remind co-investors that most of our liquid wealth sits in the same fund as yours. We, therefore, share in the ‘ups’ and inevitable ‘downs’ alongside you.

Warmly,

David Eborall
Portfolio Manager

Appendix

The author’s recent Zwift Ride.



Disclaimer

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