FRAZIS

• CAPITAL PARTNERS •

# December Investment Update

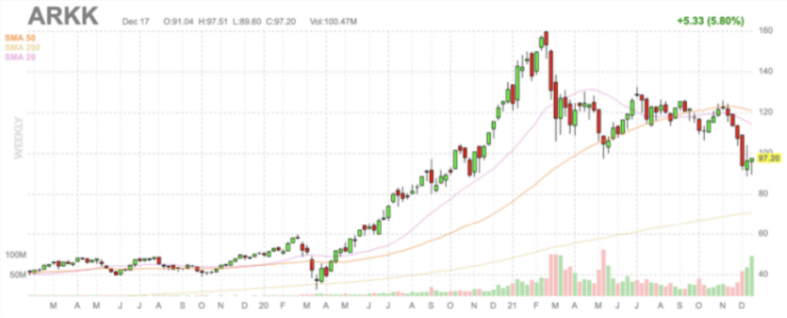
***If you were forwarded this you can subscribe to our updates here, and past letters here.***

Dear investors and well-wishers,

The fund declined -7.4% in November leaving us +9% net for the last twelve months and +22% net since inception. I will host a webinar this Wednesday at 10.30am Sydney time, please register here.

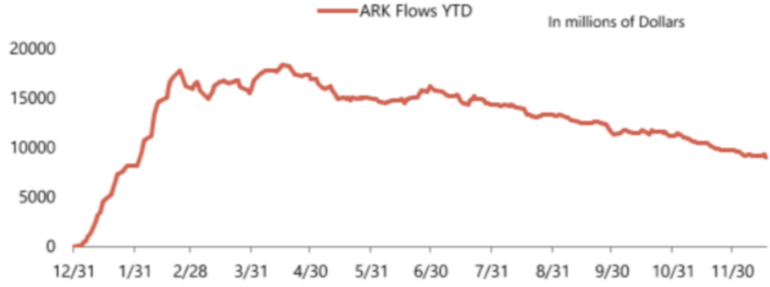
There has been a sharp rotation out of growth stocks over the past two months, and within the tech space, out of faster growing companies into megacaps like Apple, Google and Microsoft.

Ark's innovation ETF, the poster child for innovation investing, is now down 22% for the year and nearly 40% from its highs. Ofcourse, even after this sell-off, ARKK remains one of the highest performing funds of recent years:



*ARKK has rewarded long term investors, even after a steep sell-off*

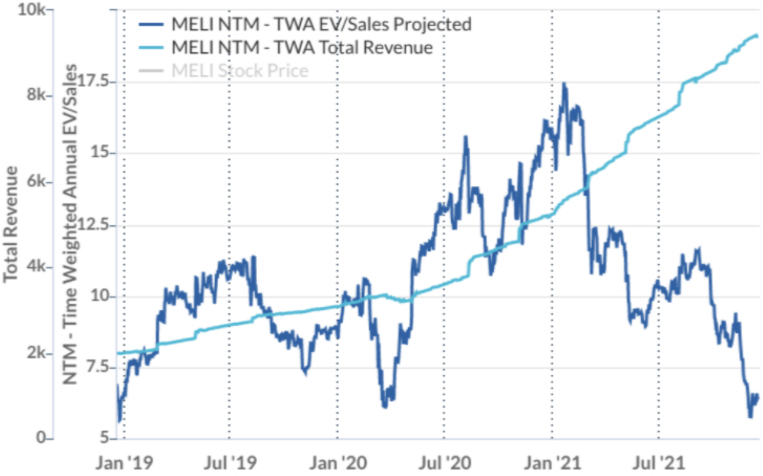
**Almost $10B withdrawn from ARK funds from peak**



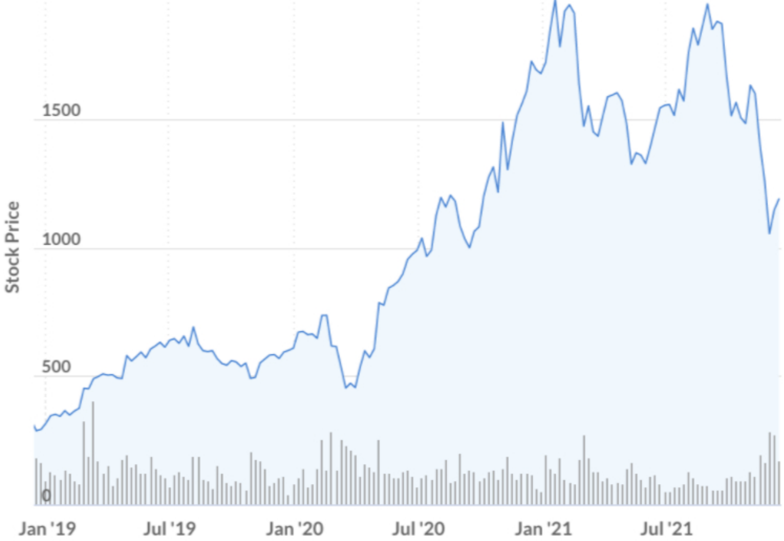
Source: FactSet; Jefferies

Companies like MercadoLibre are now trading at levels last seen in the coronavirus crash of March 2020 and the interest rate driven sell-off of December 2018.

If you wanted another chance to buy growth stocks at the valuation lows of last March, there are plenty of opportunities today.



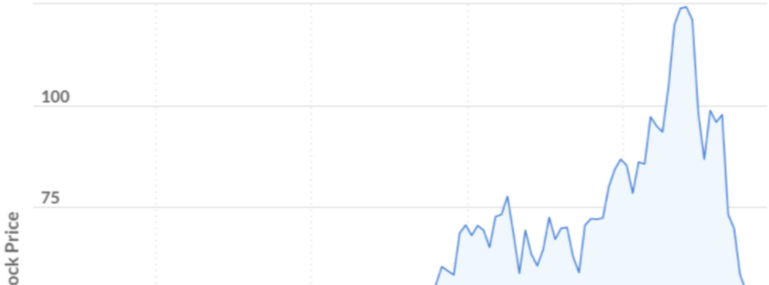
*MercadoLibre's EV/Sales multiple dropped to levels last seen in Dec 2018 and March 2020, while fundamental performance, in this case measured by the light blue line, has been excellent*

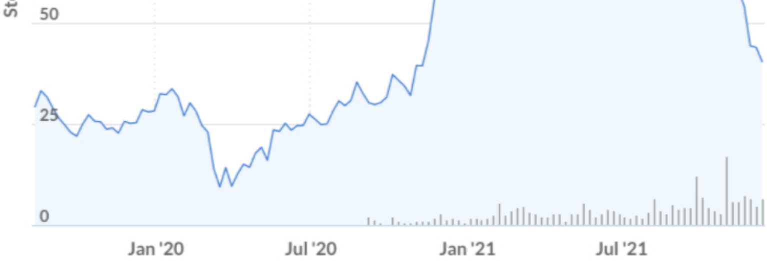


*MercadoLibre's share price. In the past, returns from these levels were exceptional.*

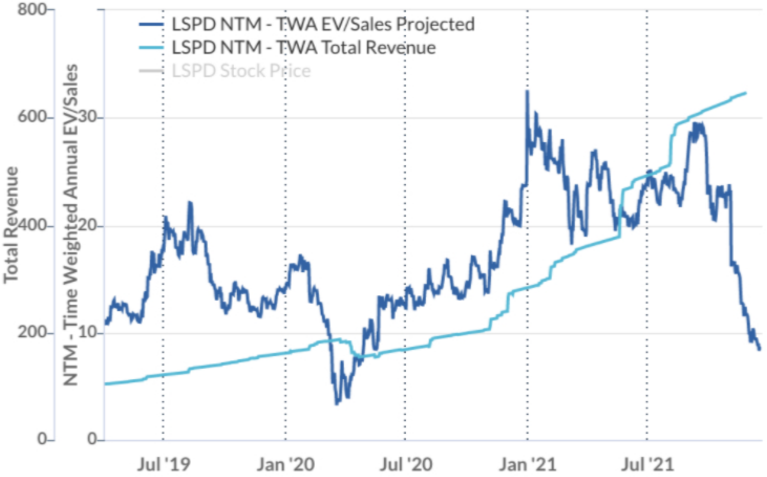
Fintechs were particularly hard hit. Afterpay timed their sale to perfection. Jack Dorsey can join the long list of people who underestimated Nick Molnar and Anthony Eisen, trading a substantial chunk of his company for comparatively little revenue and gross profit.

Other companies were not so lucky. Lightspeed, for example, offering payment solutions to small businesses, lost three quarters of its value over the past two months, falling from >$120 in November to $40 today.





*Lightspeed stock price*



*Lightspeed's EV/Sales multiple has approached, but not quite reached, the lows of March 2020*

**Interest rates**

There's a narrative floating around that rising interest rates are causing multiple contractions in growth stocks. Curiously, interest rates have actually fallen over the last few weeks.

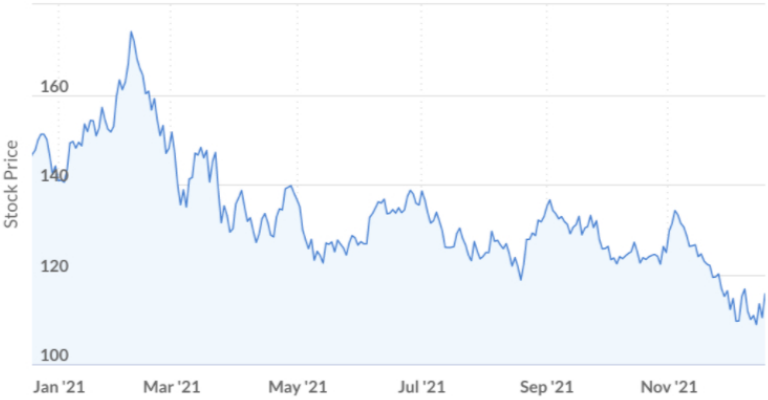
This suggests weakness in the broader economy that has perhaps not been seen in the data yet. The high prices of 2021 may have caused more demand destruction than supposed.

If there has been material deterioration in fundamentals across the economy, there is a silver lining, as the Fed will switch to a softer stance faster than anticipated.

Rather than rates, the best explanation is that sentiment and flows have swung from ultra bullish to ultra bearish in the growth space.

**Life sciences**

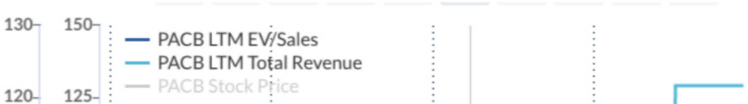
The biotech index is now down 34% from earlier this year, but that masks more dramatic moves under the surface.

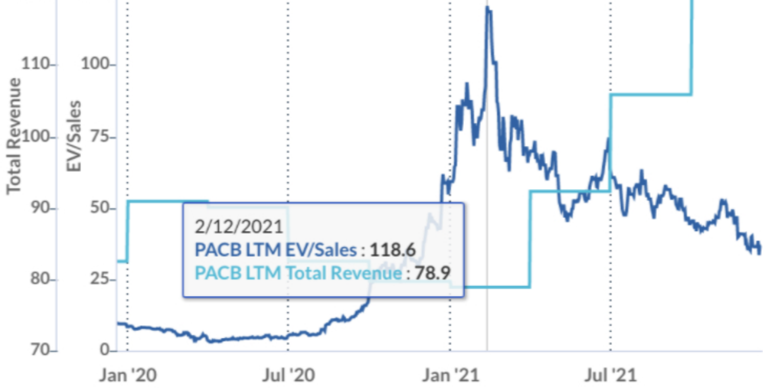


*S&P Biotech ETF*

Some scientific equipment manufacturers were bid up to well over 100x EV/Sales earlier in the year, largely due to inflows into certain funds who piled into what were small companies chasing small markets: academic institutions and research divisions.

As an example, earlier in the year Pacific Biosciences rose to almost 120x sales:





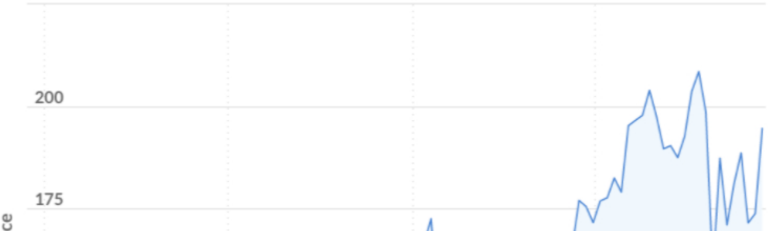
Companies like this are still a long way from offering compelling entry points.

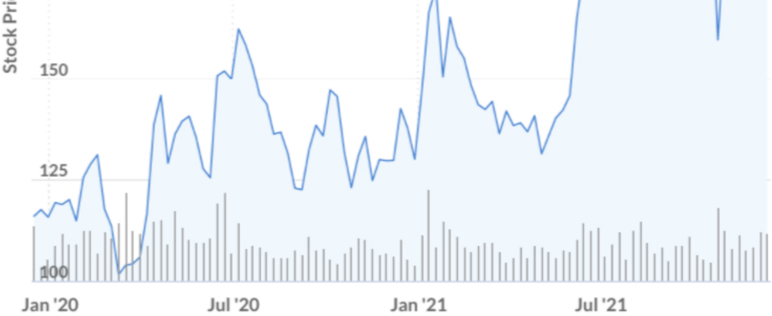
However, elsewhere in the life sciences space there are extraordinary opportunities on offer, with some companies trading at or close to cash levels. These are where we are focusing our attention.

**RNA platforms**

Moderna has been resilient despite widespread reversals in other coronavirus beneficiaries, as the increasingly clear need for annual COVID boosters has outweighed the somewhat disappointing early data from their influenza program.

Our other core RNA platform, Alnylam, (developing RNAi, rather than mRNA) has also performed well, and is targeting four new drug applications a year in large indications like hypertension and kidney stones, to join its four existing revenue generating treatments for liver diseases.





*Alnylam has performed well by delivering new treatments to patients*

There has been a dramatic dispersion in performance between platforms like Alnylam that have delivered new treatments to patients, and those that were hyped up but have yet to deliver, like CRISPR.

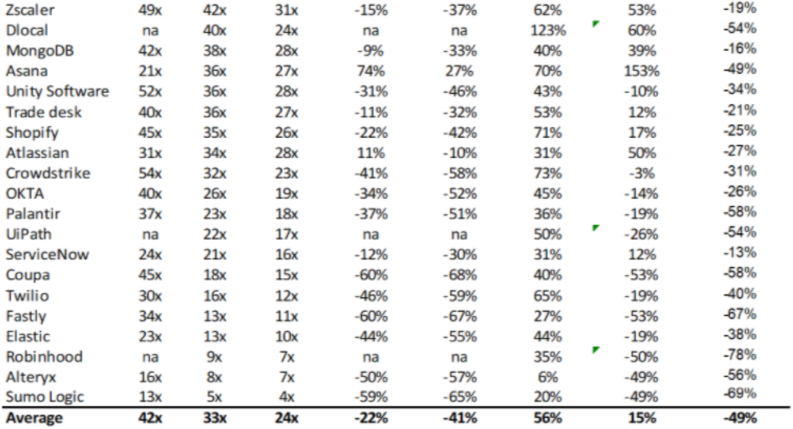
**Outlook**

After significant market moves in global growth and innovation, stocks are falling into two categories: those that are at or approaching March 2020 valuation lows, and those that are down but still trading richly on absolute values.

| | EV/Sales 2020 | EV/Sales 2021 | EV/Sales 2022 | Change 2020-2021 | Change 2020-2022 | Growth rate | YTD price change | Distance from 52wh |
|---|---|---|---|---|---|---|---|---|
| Tesla | 21x | 18x | 13x | -15% | -38% | 66% | 32% | -25% |
| Shopify | 45x | 35x | 26x | -22% | -42% | 71% | 17% | -25% |
| OpenDoor | 4x | 2x | 1x | -59% | -80% | 91% | -37% | -64% |
| MercadoLibre | 21x | 9x | 6x | -58% | -69% | 89% | -29% | -41% |
| Sea | 22x | 12x | 8x | -48% | -65% | 131% | 7% | -43% |
| Upstart | 13x | 14x | 10x | 8% | -26% | 250% | na | -65% |
| Carvana | 8x | 3x | 3x | -56% | -67% | 123% | -7% | -41% |
| Opendoor | 4x | 2x | 1x | -59% | -80% | 91% | -37% | -64% |
| Coinbase | na | 7x | 7x | na | na | 316% | -3% | -43% |
| Square | 10x | 4x | 4x | -58% | -61% | 73% | -23% | -42% |
| **Simple average** | **17x** | **11x** | **8x** | **-41%** | **-59%** | **130%** | **-9%** | **-45%** |

*Selection of portfolio stocks from 31 Dec 2020, and forecasted values for 31 Dec 2021 and 31 Dec 2022*

| Software | EV/Sales 2020 | EV/Sales 2021 | EV/Sales 2022 | Change 2020-2021 | Change 2020-2022 | Growth rate | YTD price change | Distance from 52wh |
|---|---|---|---|---|---|---|---|---|
| Snowflake | 133x | 81x | 49x | -39% | -63% | 111% | 18% | -18% |
| Cloudflare | 51x | 66x | 48x | 28% | -6% | 51% | 77% | -39% |
| SentinelOne | na | 59x | 34x | na | na | 127% | 37% | -39% |
| Datadog | 48x | 53x | 37x | 9% | -24% | 63% | 73% | -15% |
| Bill.com | 52x | 44x | 33x | -15% | -37% | 78% | 79% | -30% |
| Confluent | na | 43x | 31x | na | na | 67% | 76% | -33% |

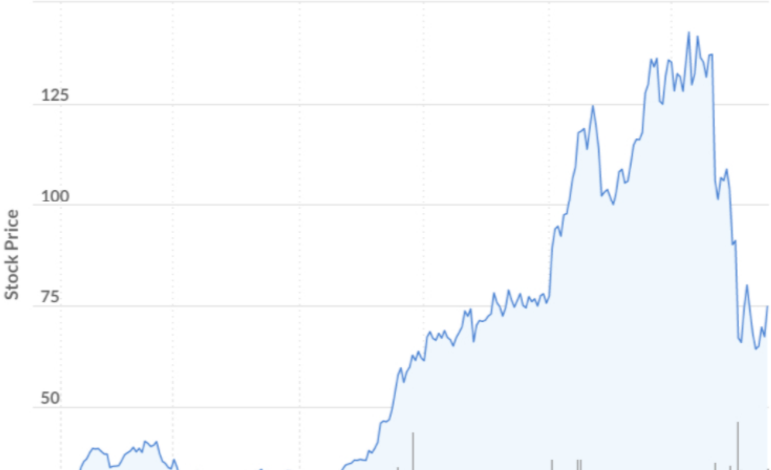


| | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Zscaler | 49x | 42x | 31x | -15% | -37% | 62% | 53% | -19% |
| Dlocal | na | 40x | 24x | na | na | 123% | 60% | -54% |
| MongoDB | 42x | 38x | 28x | -9% | -33% | 40% | 39% | -16% |
| Asana | 21x | 36x | 27x | 74% | 27% | 70% | 153% | -49% |
| Unity Software | 52x | 36x | 28x | -31% | -46% | 43% | -10% | -34% |
| Trade desk | 40x | 36x | 27x | -11% | -32% | 53% | 12% | -21% |
| Shopify | 45x | 35x | 26x | -22% | -42% | 71% | 17% | -25% |
| Atlassian | 31x | 34x | 28x | 11% | -10% | 31% | 50% | -27% |
| Crowdstrike | 54x | 32x | 23x | -41% | -58% | 73% | -3% | -31% |
| OKTA | 40x | 26x | 19x | -34% | -52% | 45% | -14% | -26% |
| Palantir | 37x | 23x | 18x | -37% | -51% | 36% | -19% | -58% |
| UiPath | na | 22x | 17x | na | na | 50% | -26% | -54% |
| ServiceNow | 24x | 21x | 16x | -12% | -30% | 31% | 12% | -13% |
| Coupa | 45x | 18x | 15x | -60% | -68% | 40% | -53% | -58% |
| Twilio | 30x | 16x | 12x | -46% | -59% | 65% | -19% | -40% |
| Fastly | 34x | 13x | 11x | -60% | -67% | 27% | -53% | -67% |
| Elastic | 23x | 13x | 10x | -44% | -55% | 44% | -19% | -38% |
| Robinhood | na | 9x | 7x | na | na | 35% | -50% | -78% |
| Alteryx | 16x | 8x | 7x | -50% | -57% | 6% | -49% | -56% |
| Sumo Logic | 13x | 5x | 4x | -59% | -65% | 20% | -49% | -69% |
| **Average** | **42x** | **33x** | **24x** | **-22%** | **-41%** | **56%** | **15%** | **-49%** |

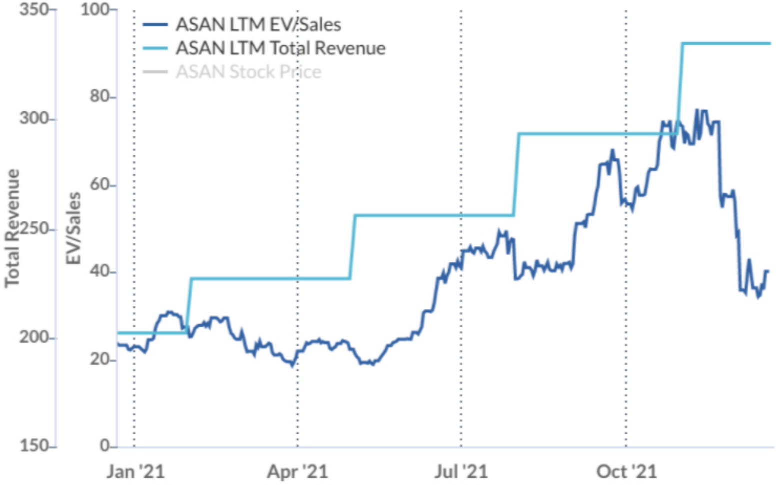
*A selection of software and growth stocks, sorted by 31 Dec 2021 EV/Sales*

We are adding to holdings in the former category, and avoiding sectors where valuations are still elevated, which includes most of the software companies above.

As a sense check, Google trades at 7x EV/Sales, and Microsoft trades at 12x. This is the future of software companies that are successful.



*Asana stock price has halved, but is still up year-to-date*



*A compression of EV/Sales from 80x to 40x EV/Sales leaves further room to fall*

In the aftermath of Dec 2018 and March 2020, we wrote in these letters why we thought the next move was up: positioning, sentiment, valuations, and central bank support.

Three of these four are now in place. Positioning and sentiment have swung from ultra bullish to consensus bearish.

Short interest has spiked to levels which historically have triggered significant rallies in stocks. And there is rising short interest in ETFs like ARKK which themselves hold heavily shorted stocks. Everyone seems to now 'know' these stocks are going down next year.

As I write, news has hit that the Democrats $2 trillion stimulus bill is unlikely to pass. In the mid to long term, this is likely to be a good thing. $2 trillion of inflationary Government spending is the last thing markets need right now, and this will ease pressure on the Fed.

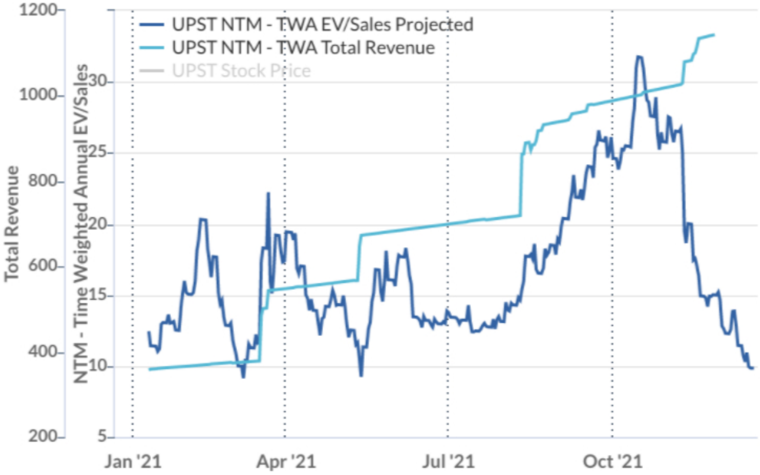
Rotations like the one we are currently in are nasty, brutish, but mercifully, often short. A significant multiple contraction now lies behind us.

We are weeks away from 2022, and this time next year our portfolio companies will be valued on their prospects for 2023, by which time many of our portfolio companies will be 2x-4x the size they were at the beginning of this year.

Multiples have dropped to levels that in the past led to extraordinary returns, and the market may have already priced in a tighter environment.

Short interest has gone from record lows to new highs, and professional investors have flocked back into the handful of slower growing blue chip stocks - laying the groundwork for periods of underperformance during which they will chase back into faster-growing parts of the market.

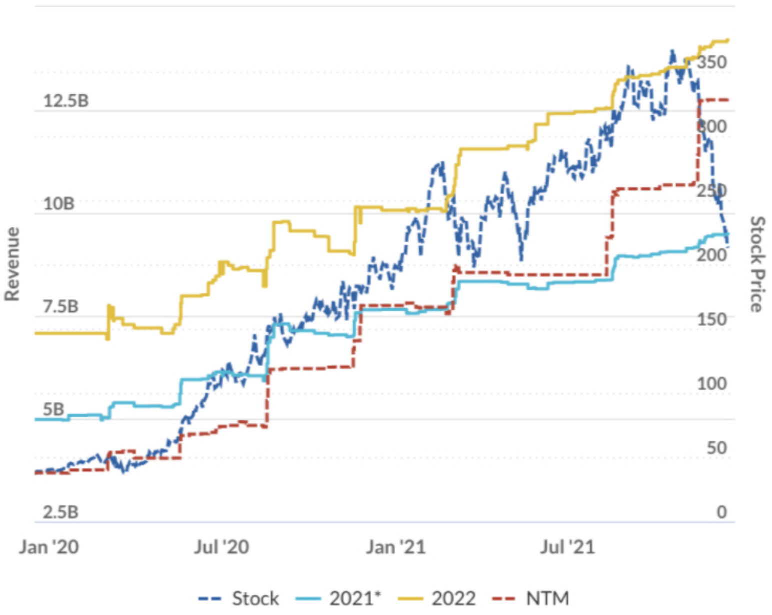
We have been fairly active. In recent days we bought Upstart, whose multiple dropped from 30x to 10x while growing revenues and EBITDA at triple digits:



*Upstart EV/Sales*

We have added to our drug discovery platforms and made new investments in the life sciences in companies that have dropped over 50%.

Portfolio companies like Sea and MercadoLibre continue to outperform their forecasts while trading on multiples >60% lower than earlier in the year.



*Sea's revenue - consistently outperforming estimates*

Our commitment is to stay invested in a portfolio of rockstar companies with immense customer support and growing at exceptional rates, irrespective of what factor or rotation is pushing around stock prices at any given time.

With many fast-growing companies trading at similar multiples to the COVID lows, this is the best opportunity set we have seen in some time, and as you might expect we are taking full advantage.

Best wishes
Michael

ps I will host a webinar this Wednesday at 10.30am Sydney time, please register here.

If you'd like to invest with us, you can access our investment portal and fund documentation through the button below, or simply reply to this email and we'll be in touch.

Invest

**Please note:** We are now taking applications weekly, so if applications, funds and supporting documents are received by 2pm on a Friday, the investment will be priced for Friday COB / Monday morning start. We are also available on Netwealth, Hub24, and other select platforms.

# Disclaimer

The information in this note has been prepared and issued by Frazis Capital Partners Pty Ltd ABN 16 625 521 986 as a corporate authorised representative (CAR No. 1263393) of Frazis Capital Management Pty Ltd ABN 91 638 965 910 AFSL 521445. The Frazis Fund is open to wholesale investors only, as defined in the Corporations Act 2001 (Cth). The Company is not authorised to provide financial product advice to retail clients and information provided does not constitute financial product advice to retail clients.

The information provided is for general information purposes only, and does not take into account the personal circumstances or needs of investors. The Company and its directors or employees or associates will use their endeavours to ensure that the information is accurate as at the time of its publication. Notwithstanding this, the Company excludes any representation or warranty as to the accuracy, reliability, or completeness of the information contained on the company website and published documents.

The past results of the Company's investment strategy do not necessarily guarantee the future performance or profitability of any investment strategies devised or suggested by the Company.

The Company, and its directors or employees or associates, do not guarantee the performance of any financial product or investment decision made in reliance of any material in this document. The Company does not accept any loss or liability which may be suffered by a reader of this document.