Special Premium Report

THE SMART INVESTOR
ALL STARS PORTFOLIO

Milestone Review 2023

INTRODUCTION

Dear Smart Investor,

Welcome to our special premium report for The Smart All Stars Portfolio.

We are on a journey together. A journey to build a growth portfolio.

It's not been easy for The Smart All Stars Portfolio.

But we are here, with you, together.

Many of you might be wondering whether it is still worth your while to invest in the US stock market. Well, Warren Buffett once said that it's wise for investors "to be fearful when others are greedy and to be greedy only when others are fearful."

At The Smart All Stars Portfolio, we continue to invest in the US market, month after month. While we look out for new additions to bolster the portfolio, we also keep a close eye on the companies within our portfolio.

For many of our members, you might be looking to take advantage and add to your portfolio, or perhaps you just want to know more about a particular stock.
In this special premium report, you'll find a comprehensive review of every single stock within The Smart All Stars Portfolio.

To make it easier for you to identify what stocks we think have more potential than others, we've ranked each of these stocks by conviction level.

1. **Conviction Level One**: This segment of stocks represents the set of companies which the portfolio will be happy to add in the future. To be clear, some of these businesses may be experiencing short-term headwinds but our focus is on the long-term sustainability of their growth.

2. **Conviction Level Two**: For stocks which have exhibited some business uncertainty, we will rank them as conviction level two stocks. This group will not be the first choice when it comes to future top-ups.

3. **Conviction Level Three**: Finally, conviction level three stocks are for businesses which have run into material issues which either cannot be easily resolved or worse, may dismantle our core investment thesis.
   Conviction level three is akin to a penalty box where the portfolio will not be adding to these stocks.

The rankings have been summarised on the next page.

STOCK RANKINGS

Conviction Level	Growth Titan Stocks	Growth Leader Stocks	Growth Trailblazer Stocks
1	Adobe Alphabet ASML Intercontinental Exchange Intuit Meta Platforms Microsoft S&P Global Salesforce Synopsys Veeva Systems Visa	Atlassian Doximity lululemon MarketAxess MercadoLibre ServiceNow Shopify Tractor Supply	
2	American Tower PayPal	Block Netflix	Fiverr MongoDB nCino Okta
3		DocuSign Illumina Roblox Zoom	Coinbase Sea Limited

May 2023

GROWTH TITANS

Adobe
Alphabet
ASML
Intercontinental Exchange
Intuit
Meta Platforms
Microsoft
S&P Global
Salesforce
Synopsys
Veeva Systems
Visa
American Tower
PayPal

Growth Titans: Conviction Level 1

Adobe (NASDAQ: ADBE)

Adobe was added to the Smart All Stars Portfolio back in April 2021, making it a two-year-old within the portfolio.

As we outlined in our case study HERE, the investment thesis is fairly straightforward:

1. Adobe has two key segments, namely Digital Media, which consists of Adobe Creative Cloud and Adobe Document Cloud, and Digital Experience, which covers analytics, digital ads, commerce and more.

2. In simple terms, Digital Media is for content creation, and Digital Experience is for reaching and understanding customers.

3. Adobe Creative Cloud sets the industry standard for creative tools while PDF documents, the key part of Adobe Document Cloud, remain as the "lingua franca" of the internet.

4. Adobe Digital Experience Cloud, on the other hand, comes integrated with a 4,000-strong network of partners along with a community of over 460,000 developers and members.

5. More importantly, both segments exhibit a high percentage of subscription-based, recurring revenue. This factor, in turn, translates to a high free cash flow margin which Adobe has maintained as it scales up.

All of the above, however, has been overshadowed by Adobe's bid to acquire Figma, which we covered extensively HERE.

The deal raised eyebrows for a couple of reasons:

1. The initial price offered, which was US$10 billion in cash and an estimated 26.5 million shares which was worth about US$10 billion at the time of the offer. Tellingly, this figure exceeded Figma's total addressable market (TAM) of US$16.5 billion.

2. The timing and size of the bid also raised questions over Adobe's ability to fend off emerging competitors, a risk we highlighted in our original case study

As we said in our December update HERE, the transaction is being reviewed by a host of regulatory bodies around the world.

In April, Adobe also completed the discovery phase of the US Department of Justice's (DOJ) second request. There are rumours that the DOJ may decide to block the deal but so far, there has been no official confirmation.

Amid the noise, the Smart All Stars Portfolio added to its position in October 2022.

Meanwhile, while the market is fixated on Figma, Adobe's business continued humming along, as evidenced by its solid 1Q'23 results which we covered in detail HERE:

1. Digital Media revenue growth was driven by new user acquisition, a signal that Adobe is no pushover when it comes to winning new customers.

2. Digital Experience revenue was also supported by its full stack of solutions which customers are looking to standardise.

The two factors above speak volumes of Adobe's competitive strengths.

Finally, the recent Adobe Summit revealed a whole host of Generative AI (GenAI) tools including Firefly, Sensei GenAI, Adobe Real-Time CDP, Adobe Experience Manager and more.

Ergo, don't be distracted by Figma.

Adobe's core business, in our eyes, is doing just fine and earns a spot as a conviction level one stock.

Growth Titans: Conviction Level 1

Alphabet (NASDAQ: GOOGL) Alphabet

Speaking of distractions, OpenAI's launch of ChatGPT and **Microsoft**'s (NASDAQ: MSFT) subsequent sabre-rattling on search had investors questioning whether Google was due to be disrupted.

Not so fast, we said.

In February 2023, we took a deep dive (it's an 18-minute read!) into the heart of the matter. As usual, the noise generated by the financial media seemed to ignore **Alphabet**'s (NASDAQ: GOOGL) strengths:

1. For one, Google's reach is near-unparalleled as it dominates the mobile space with Android and holds the default search position on Apple's iOS. On desktop, Microsoft CEO Satya Nadella made a rare admission that Google made more money on Windows than all of Microsoft.

2. Secondly, Google is not just about search, there's YouTube, Google's Ad Network, and Google Cloud, to name a few.

3. Thirdly, the global ad market, estimated to be worth US$795 billion in 2022 is large enough to host several competitors.

Then, during Alphabet's Google I/O, the search engine giant responded blow-for-blow to everything that Microsoft announced, and then some:

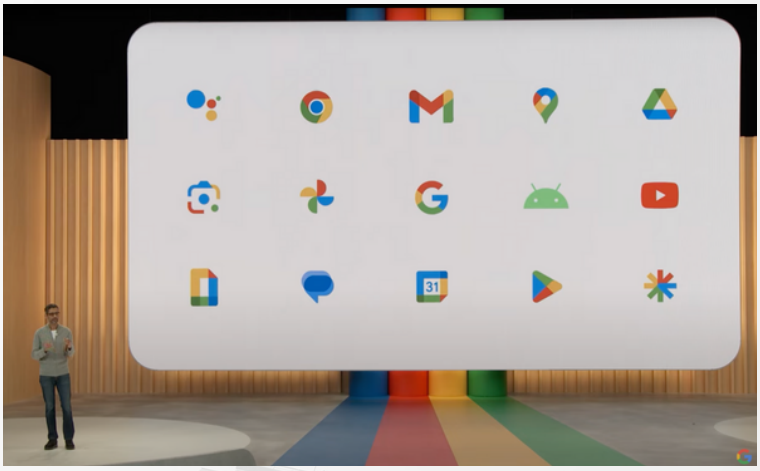
1. First, there was the introduction of the PaLM 2 language model, its answer to OpenAI's GPT-4. PaLM 2 is trained in over 100 languages, with the promise of a better understanding of linguistic nuances, an improved ability in reasoning, and higher familiarity with popular programming languages such as Python and JavaScript.

2. Crucially, PaLM 2 is already powering 25 new products and features within Google. These range from Workspace, a feature to help you write in Gmail and Google Docs, to Med-PaLM 2 and Sec-PaLM 2, two industry-specific language models designed for healthcare and security use cases, respectively.

3. Google also introduced Bard Extensions, its answer to ChatGPT plugins. Partners such as **Adobe** (NASDAQ: ADBE) are already integrating Bard extensions with Adobe Firefly, the former's family of creative generative AI models for producing high-quality images.

4. Other early adopters are varied, including **Booking Holdings**' (NASDAQ: BKNG) Kayak and OpenTable, **Walmart** (NYSE: WMT), the Khan Academy, Wolfram, **Zillow** (NASDAQ: ZG), **Uber** (NYSE: UBER) Eats, **TripAdvisor** (NASDAQ: TRIP), **Redfin** (NASDAQ: RDFN), **Spotify** (NYSE: SPOT) and more.

More importantly, Alphabet CEO Sundar Pichai highlighted that Google has 15 products that serve over 500 million users, as shown in the screenshot below.



Source: Screenshot from YouTube (Google I/O)

For six of the products above, namely Google Search, Gmail, Android, Chrome, YouTube and Google Play, the number of users exceeds two billion.

This demonstration speaks to Google's immense product breadth and scale that few, if any, can match — and is also a key factor we highlighted in our August 2022 case study HERE.

Source: Screenshot from YouTube (Google I/O)

Alphabet's growth has slowed since it became an All Star stock back in August last year.

In 1Q'23, Google Services revenue rose by only 1% year on year, in part due to declines in YouTube ad revenue and Google Network revenue.

To be sure, the Mountain View company is seeing signs of stabilisation at YouTube as it works on monetising its Shorts video format (think TikTok).

Revenues, Traffic Acquisition Costs (TAC), and number of employees

	Quarter Ended March 31,	
	2022	2023
Google Search & other	$ 39,618	$ 40,359
YouTube ads	6,869	6,693
Google Network	8,174	7,496
Google advertising	54,661	54,548
Google other	6,811	7,413
Google Services total	61,472	61,961
Google Cloud	5,821	7,454
Other Bets	440	288
Hedging gains (losses)	278	84
Total revenues	$ 68,011	$ 69,787
Total TAC	$ 11,990	$ 11,721
Number of employees[1]	163,906	190,711

Source: Alphabet's latest earnings

Google Cloud, on the other hand, continues to impress:

1. In 1Q'23, segment revenue rose by a pleasing 28% year on year.

2. Google Cloud also recorded its first-ever positive operating profit of US$191 million for the quarter, in part due to a change in the estimated useful life of Google's servers and network equipment.

Other positives include Alphabet's share buybacks.

1. After spending US$59 billion on buybacks last year, the board of directors has approved an additional US$70 billion in stock repurchases.

2. For context, Alphabet generated US$60 billion in free cash flow (FCF) for 2022 therefore we do not expect the company to break a sweat over financing these buybacks.

3. In just nine months since Alphabet became a part of the Smart All Stars Portfolio, its share count has declined by 4.2%.

Growth Titans: Conviction Level 1

ASML Holdings (NASDAQ: ASML)

ASML is a youngster in the Smart All Stars Portfolio with less than seven months under its belt.

You may check out our deep-dive October 2022 case study HERE where we dug deep into its history and found how it took 19 years to develop its ground-breaking extreme-ultraviolet (EUV) lithography process.

We believe that its headstart will be hard to match.

In fact, the key discussions around ASML's business today is about how it can fulfil the orders which far exceed its manufacturing capacity:

1. Despite the cyclical downturn in the semiconductor industry, in April 2023, the Dutch company said that its backlog covers its production capacity for this year and most of next year.

2. For context, it plans to ship around 60 EUV systems and about 375 deep UV systems in 2023 which should lift its net revenue by over 25% this year.

3. Looking ahead, ASML expects to increase its annual capacity to 90 EUV and 600 DUV systems by 2026. The company is also ramping up its next-generation High-NA EUV capacity to 20 systems by 2028.

In short, it's a fairly straightforward company to follow.

Of course, we are always on the watch for potential risks. But as it stands, the company is a solid conviction level one stock for the Smart All Stars Portfolio.

Growth Titans: Conviction Level 1

Intercontinental Exchange (NYSE: ICE)

Intercontinental Exchange or ICE's 2023 first quarter (1Q'23) provides a demonstration of the all-weather nature of its business.

Faced with a 60% decline in mortgage origination volumes, ICE managed to hold its net revenue steady:

1. ICE's Mortgage Technology segment limited its decline in revenue to 23% on the back of a base of recurring revenue which brought in US$165 million for the quarter or 70% of the segment's revenue.

2. From there, the other two segments, namely the Exchanges division and the Fixed Income and Data Services division, were able to erase the revenue shortfall from Mortgage Technology.

3. In sum, ICE was able to hold its topline relatively unchanged from a year ago.

	Three Months Ended March 31,	
Revenues:	**2023**	**2022**
Exchanges	$ 1,673	$ 1,643
Fixed income and data services	563	509
Mortgage technology	236	307
Total revenues	2,472	2,459
Transaction-based expenses:		
Section 31 fees	119	51
Cash liquidity payments, routing and clearing	457	509
Total revenues, less transaction-based expenses	1,896	1,899

Source: ICE's earnings release

This is one of the unique qualities that attracted us to the business back in July 2020.

For the original case study, click HERE.

The reliability of its revenue is a key factor.

ICE is historically an acquisitive company. To be able to fund its mergers and acquisition (M&A) activity, the company needs to be backed by growing free cash flow while taking on debt.

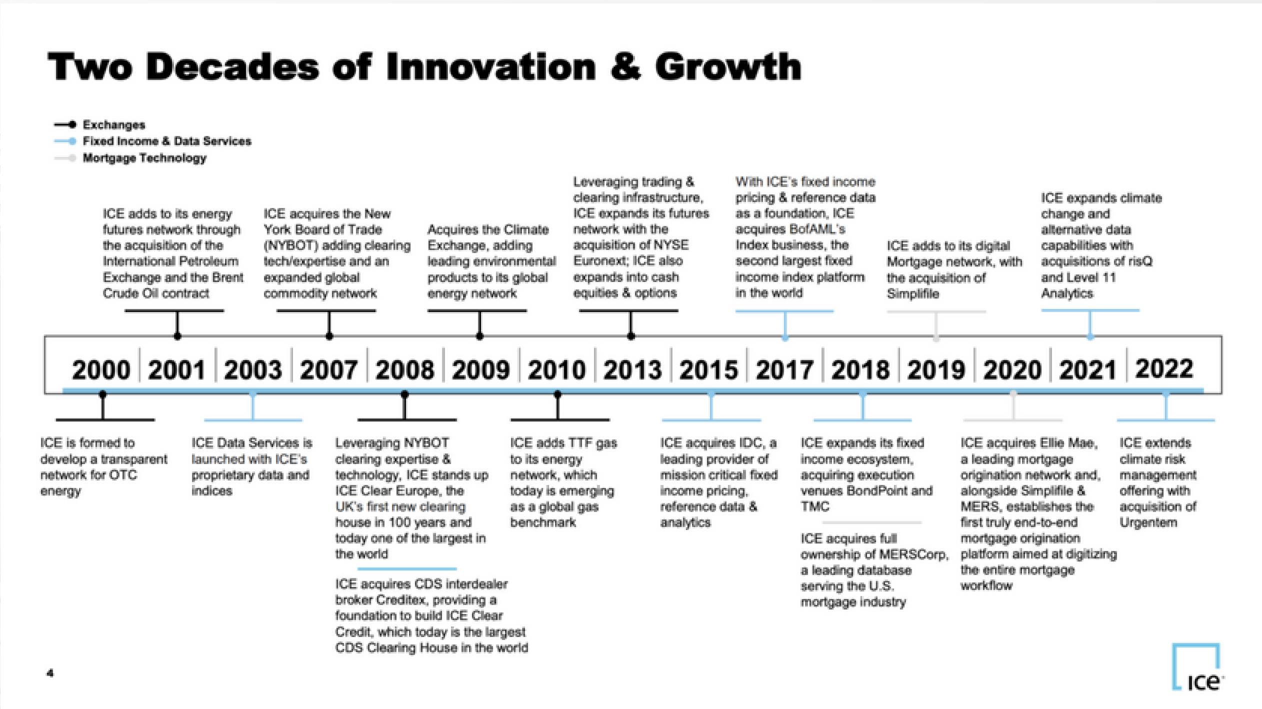
On the surface, ICE's playbook looks deceptively simple:

1. Firstly, the company targets markets and asset classes where there is an analogue to digital conversion taking place.

2. After acquiring its target, ICE leverages its core expertise in operating network marketplaces and digitalisation.

3. By operating an exchange or marketplace, ICE is able to generate important, proprietary data which then allows the company to perform analytics, repackage the information, and then sell to third parties.

What's unusual is its ability to execute this process successfully for over 20 years.



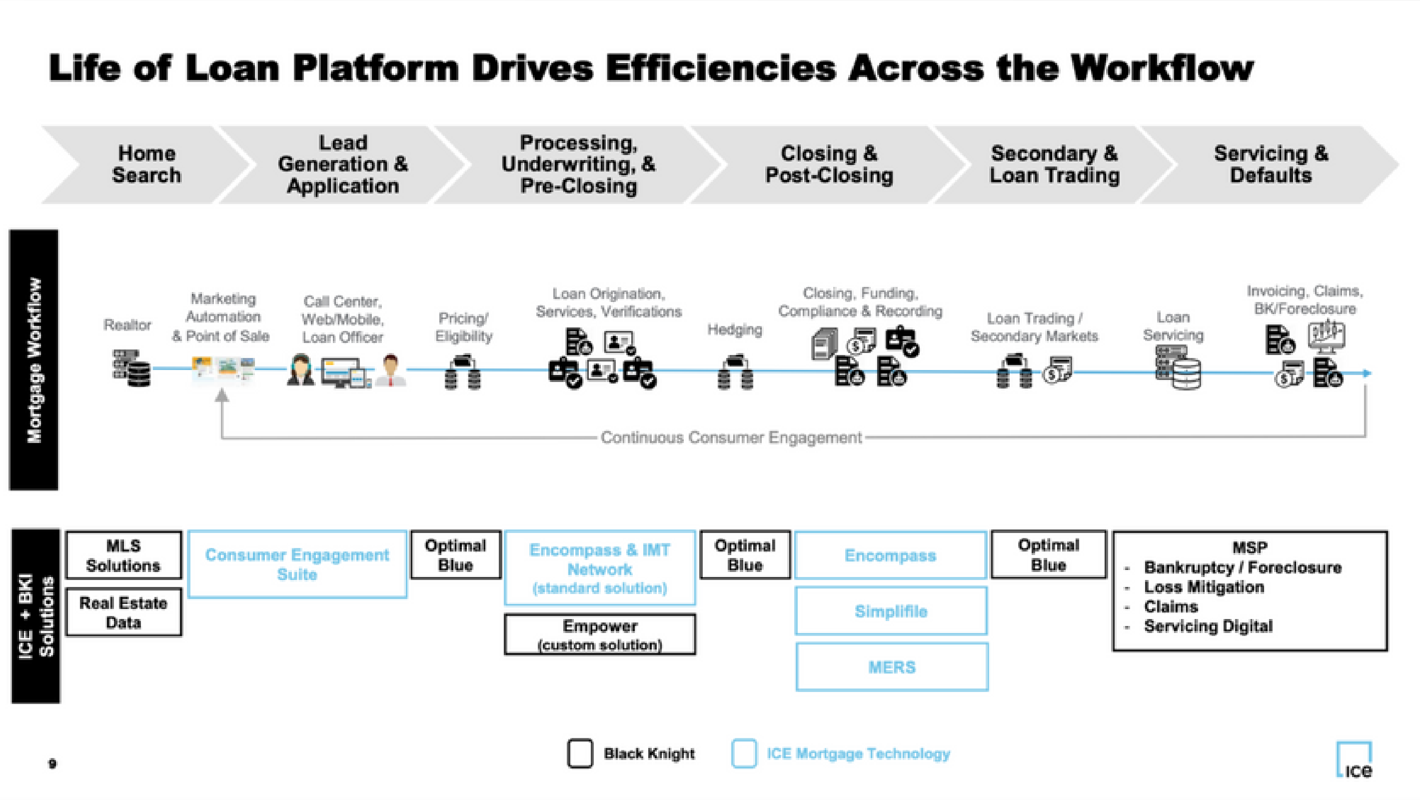
Source: ICE's investor overview

The most interesting acquisition over the past three years, without a doubt, has been the acquisition of Ellie Mae which we covered in great detail HERE.

What's exciting about this acquisition is that it enabled ICE to build a third leg of growth: Mortgage Technology.

True to form, ICE will not be stopping here.

In May 2022, the exchange operator made a bid for **Black Knight** (NYSE: BKI). ICE expects the latter to fill some of the gaps across the mortgage workflow which would, in turn, enable the company to assemble an end-to-end loan platform.



Source: ICE's Black Knight acquisition presentation

Given its scale, the deal has come under scrutiny.

In 1Q'23, CEO Jeff Sprecher said that ICE has offered to sell Black Knight's Empower loan origination system to Canada's Constellation Software (OCT: CNSWF) to allay regulatory concerns.

In conjunction with the announcement, ICE has also revised the terms of the Black Knight acquisition agreement from US$85 per share previously down to US$75 per share or a market value of US$11.7 billion.

As it stands, the deal has yet to be approved.

Either way, we like where the company is headed and that's why it is a conviction level one stock.

Growth Titans: Conviction Level 1

Intuit (NASDAQ: INTU)

IIntuit is a 40-year company but a youngster in the Smart All Stars Portfolio.

We have covered the business extensively in our February 2023 case study HERE, therefore we will keep our commentary brief for this milestone review.

Here are the key highlights:

1. The cornerstone of Intuit's success is its focus on deep customer empathy. Every product and solution created starts from the customer's most pressing problems.

2. Intuit has cornered the market for accounting software for small businesses and the self-employed (SBSE), holding an estimated 80% US market share for the financial year ended 31 July 2022 (FY22). This segment accounts for 51% of Intuit's FY22 revenue and operating income.

3. The company also has an enviable position in the consumer tax-prep market, where its flagship TurboTax helped process 47 million US tax returns and US$113 billion in tax refunds for FY22. The consumer segment contributed a little under a third of its 2022 topline.

4. The third major segment would be Credit Karma which occupied 14.2% of its FY22 topline after being acquired in December 2020.

5. In the near term, a key driver of growth is TurboTax Live which has gone from zero to US$1 billion in annual sales in less than five years. Intuit's ability to cross sell online services on QuickBooks such as QuickBooks Payroll, QuickBooks Payments, and QuickBooks Capital has also been remarkable, increasing sales from this sub-segment on par with its core QuickBooks accounting revenue.

6. The five points above show up in its financials where it has been a consistent generator of free cash flow. Crucially, the cash helps to fund the company's five Big Bets for the future, namely to revolutionise speed to benefit using AI, connecting people to experts, unlock smart money decisions, be the centre of small business growth and disrupt the small business mid-market.

The reasons above make Intuit a shoo-in as a conviction level one stock.

Growth Titans: Conviction Level 1

Meta Platforms (NASDAQ: META)

On the surface, Meta does not look like a conviction level one stock.

Since making its debut in the Smart All Stars Portfolio back in February 2022, the company has undergone an equivalent of a baptism by fire:

1. In the same month, Facebook reported a loss of a million daily active users (DAUs). From the start, we felt that the media had made a whale out of an ikan bilis. The loss represented 0.05% of its overall DAU, hardly a matter to raise an alarm.

2. To be fair, the social media network was also hit with a trio of headwinds: firstly, **Apple**'s (NASDAQ: AAPL) new AppTracking Transparency (ATT) framework restricted access to user data, secondly, the emergence of competition from TikTok and third, a weaker advertising environment. The three factors were covered HERE and HERE.

3. Meta CFO David Wehner added that the iOS update would cause a US$10 billion headwind on its revenue for 2022.

We won't lie. Time was needed for a turnaround.

In the meantime, the lack of information made the situation look dire. Under these circumstances, Meta needed the benefit of the doubt.

As such, despite the difficulties:

1. We reminded our members that Facebook has fended off competition in the past.

2. We also took time to point out that Meta is not just about TikTok-style short-form videos. As we detailed HERE, the company also has Groups (1.8 billion monthly active users), Marketplace (one billion visitors every month), Shops (over 250 million monthly visitors) and Gaming (over 350 monthly active users), to name a few.

3. We also knew that Meta needed time to figure out a solution for Apple's ATT framework.

That's why we said that the combination of a seasoned management team, led by a highly-vested founder, and backed by plenty of financial firepower is as good as a hand you can hope to see a turnaround in fortunes.

Patience, of course, was needed.

Then, little by little, the good news trickled in amid the noise:

1. In 2022's first quarter (1Q'22), Meta said that its "click-to-message" ads had become a multi-billion dollar business. Then, in 3Q'22, the social network company said the ad product had grown to a US$9 billion annual run rate. By the next quarter, the figure had risen to US$10 billion.

2. Reels, Meta's answer to TikTok, started to gain traction, accounting for 20% of time spent on Instagram in 1Q'22. Two quarters later, Meta reported that over 140 billion Reels were played each day across Facebook and Instagram while being reshared a billion times a day. By 1Q'23, resharing doubled to two billion per day.

3. In 3Q'22, the company said that Reels revenue had reached a US$3 billion annual run rate, up from US$1 billion in 2Q'22; the gap between Reels and its other high-monetising surfaces had narrowed to US$500 million.

4. To top it off, in 4Q'22, Meta said that it now expects Reels to close this gap by the end of 2023.

The sequence of events above is nothing short of extraordinary; a telling demonstration of why an investor's patience is needed for results.

Mind you, it wasn't blind faith.

Our conviction is built on years of observing how committed founders, given time, rarely disappoint.

Meanwhile, Meta has gone on the offensive, ramping up investments in AI:

1. Reels recommendations are partly powered by AI, leading to incremental time spent on its apps. In fact, if we zoom out, Meta said that over 20% of its content in 1Q'23 on Facebook and Instagram was recommended by AI.

2. In particular, about 40% of Instagram content is served up by AI, leading to a pleasing 24% increase in engagement. More time spent on the app, of course, increases the chance of future monetisation.

3. Facebook's Advantage+, which is powered by Generative AI (GenAI), helps the social media company to overcome Apple's ATT framework. For instance, the solution enables advertisers to create up to 50 ads at a time with fewer inputs, thereby facilitating rapid ad optimisation to achieve a higher return on ad dollars spent. Initial results are promising; daily revenue from Advantage+ Shopping Campaigns is up by over seven times over the past six months.

4. Speaking of GenAI, Meta has taken a different tact, opting for an open-source approach. In 1Q'23, Meta released LLaMA (Large Language Model Meta AI) to researchers. The models are available in different size parameters (7 billion, 13 billion, 33 billion and 65 billion). At the same time, the social media company also announced its first custom silicon chip for running AI models and a new AI-optimised data centre design.

While most observers see **Alphabet** and **Microsoft** (NASDAQ: MSFT) as frontrunners in LLM models, Meta could be a dark horse in the race.

In sum, we want to acknowledge two things:

1. Meta's growth in the near term has been weak.

2. The company's spending on the metaverse continues unabated, depressing its free cash flow.

Based on the above, we did consider placing Meta as a conviction level two stock.

However, we also want to recognise that the company has responded well to the three headwinds and has proven again that it is able to wrest back control of its future.

On that basis, Meta has earned a conviction level one stock rating.

Growth Titans: Conviction Level 1

Microsoft (NASDAQ: MSFT)

Microsoft is among the second pair of stocks added to the Smart All Stars Portfolio back in June 2020.

It's not hard to see why.

The Redmond company has multiple streams of revenue which all come together to form a juggernaut of a company.

Here is a collection of interesting stats and metrics we have shared over the past year alone:

1. GitHub, a software development platform acquired in 2018, has amassed an impressive 100 million developers, as of the second quarter of the financial year ending 30 June 2023 (2Q'FY23)

2. During the same quarter, Microsoft 365 also had 63 million consumer subscribers while on the Enterprise end, eight out of every 10 customers use five or more Microsoft 365 applications (read: sticky!). Microsoft Teams also surpassed 280 million monthly active users (MAU).

3. In 1Q'FY23, Dynamics 365 had amassed over 400,000 organisations while Power Apps leads the low-code to no-code tools space with almost 15 million monthly active users.

4. Enterprise mobility and security installed base rose to more than 218 million in 4Q'FY22. Two quarters later, Microsoft said its security business had exceeded US$20 billion over the past 12 months, doubling from where it was two years ago.

5. In 2Q'FY22, the number of monthly active devices running on Windows 10 or Windows 11 reached 1.4 billion. During the same quarter, CEO Satya Nadella said that Microsoft's ad revenue, including Linkedin, had surpassed US$10 billion.

Above all, the two key areas to watch are:

1. Microsoft Cloud revenue surpassed 50% of the Redmond company's 1Q'FY23 total revenue. We expect digitalisation to continue to be a key driver of its overall growth, similar to what we highlighted in our original June 2020 case study HERE.

2. Microsoft has also earned itself a front-row seat in the nascent Generative AI (GenAI) trend via its early investment in OpenAI back in July 2019. The pace of product announcements has only sped up since then, as we detailed HERE.

Despite being a US$2.3 trillion dollar company, its best days may still be ahead — that's why it's a conviction level one stock.

Growth Titans: Conviction Level 1

S&P Global (NYSE: SPGI)

S&P Global is the 15th stock to be added to the Smart All Stars Portfolio back in December 2020.

At the time of its addition, the company had already made a bid to acquire IHS Markit which we covered in our detailed update HERE.

The move echoes S&P Global's history of assembling valuable franchises and stitching them together.

Finally, 14 months after S&P Global made its debut in the portfolio, the merger with IHS Markit was finally formalised in February 2022:

1. To convince the regulators to approve the deal, both S&P Global and IHS Markit had to shed parts of their business. Details can be found HERE.

2. Post-merger, S&P Global business would consist of six major divisions, namely, S&P Global Market Intelligence, S&P Global Ratings, S&P Global Commodity Insights, S&P Global Mobility, S&P Global Dow Jones Indices and S&P Global Engineering Solutions.

3. A year later, S&P Global decided to sell the Engineering Solutions division to KKR for US$975 million, detailed HERE. We expect the impact to be minimal as the division only accounted for 3% of S&P Global's 2022 revenue.

Mergers are often a little messy financially due to one-off integration costs, coupled with the timing of the new revenue making its debut.

That's why we decided to do a detailed check-in HERE (a 24-minute read!) timed a year after the merger.

The report also included the company's presentation during its investor day, providing us with deep insight into why S&P Global's depth in data and in-depth expertise is so hard to replicate.

In the near term, we should expect revenue growth to be uneven due to headwinds at the Ratings division and uncertainties in the banking sector.

Beyond that, we have little doubt that S&P Global is a conviction level one stock.

Growth Titans: Conviction Level 1

Salesforce (NYSE: CRM)

Salesforce (NYSE: CRM) was among the pair of stocks the portfolio first added back in May 2020.

We view Salesforce as the original software-as-a-service (SaaS) success story, blazin' the path for future SaaS firms to follow.

Salesforce's playbook is filled with lingo which now is common in the SaaS world.

The SaaS firm's Dreamforce 2022 presentation, which we covered in great detail HERE, provides key statistics as to why the business is so valuable:

1. GitHub, a software development platform acquired in 2018, has amassed an impressive 100 million developers, as of the second quarter of the financial year ending 30 June 2023 (2Q'FY23)

2. During the same quarter, Microsoft 365 also had 63 million consumer subscribers while on the Enterprise end, eight out of every 10 customers use five or more Microsoft 365 applications (read: sticky!). Microsoft Teams also surpassed 280 million monthly active users (MAU).

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5. In 2Q'FY22, the number of monthly active devices running on Windows 10 or Windows 11 reached 1.4 billion. During the same quarter, CEO Satya Nadella said that Microsoft's ad revenue, including Linkedin, had surpassed US$10 billion.

Note: As we highlighted in our Portfolio Spotlight (Cloud Computing) Lesson #11 HERE, vertical SaaS will become more common in the future as horizontal SaaS companies such as Salesforce seek to deepen their industry penetration.

At the moment, Salesforce is facing scrutiny from activist investors such as Elliott Management Corporation, Inclusive Capital Partners, Starboard Value, ValueAct Capital and Third Point.

In particular, the SaaS firm has come under fire for its acquisition strategy. There may be some merit to these criticisms.

Salesforce's "once in a generation" move to acquire Slack, which we covered in extensive detail HERE, does not seem to have delivered on its promise to position Slack as the central nervous system that pulls multiple workflows together.

Some may see the presence of activist investors as a nuisance.

However, we view their presence as the recognition of Salesforce's value.

To his credit, CEO Marc Benioff has responded well:

1. Salesforce has brought forward its margin targets and disbanded its M&A committee while increasing its share buyback mandate, steps that were requested by Elliott.

2. The SaaS firm has also invited ValueAct's Mason Morfit to join its board of directors while welcoming input from the fund's founder Jeff Ubben.

We will be keeping a watchful eye on the activist activities. That said, none of the above has distracted us from the simple truth: Salesforce is a conviction level one stock.

Growth Titans: Conviction Level 1

Synopsys (NYSE: SNPS)

Last month was Synopsys's one-year anniversary in the Smart All Stars Portfolio.

The electronic design automation (EDA) company may not be the fastest runner in the Titan field but it is one of the most reliable.

1. In the second quarter of the fiscal year ending 31 October 2023 (2Q'FY23), Synopsys reported a non-cancellable backlog worth US$7.3 billion, a figure which is equivalent to roughly 1.4 years of revenue.

2. Around two-thirds of Synopsys's 2Q'FY23 revenue is from its core Design Automation segment where it holds a duopoly position together with its peer, **Cadence Design Systems** (NASDAQ: CDNS).

3. Synopsys's favoured position is demonstrated in its recent collaboration with Taiwan's **TSMC** (NYSE: TSM) to deliver digital and custom-designed EDA flows for the latter's most advanced 2-nanometer process node.

4. Complementing its core business is Synopsys's IP and system integration segment which accounted for roughly a quarter of its 2Q'FY23 topline. The EDA provider boasts a portfolio with more than 7,500 IP components supporting 340 process technologies, all geared towards smart, secure, and safe innovation practices.

5. The Software Integrity segment is the final piece of Synopsys' business, accounting for around a 10th of its latest quarter's revenue. Revenue recently passed the US$500 million mark on a trailing 12 months (TTM) basis and is expected to be the fastest grower among the three segments, as we highlighted in our case study HERE.

Among the most exciting developments within Synopsys is its DSO.ai artificial design solution which we highlighted during our December 2022 Top Favourite Stocks HERE.

During its 2Q'FY23 earnings briefing, CEO Aart de Geus provided more details about the solution while upping the ante:

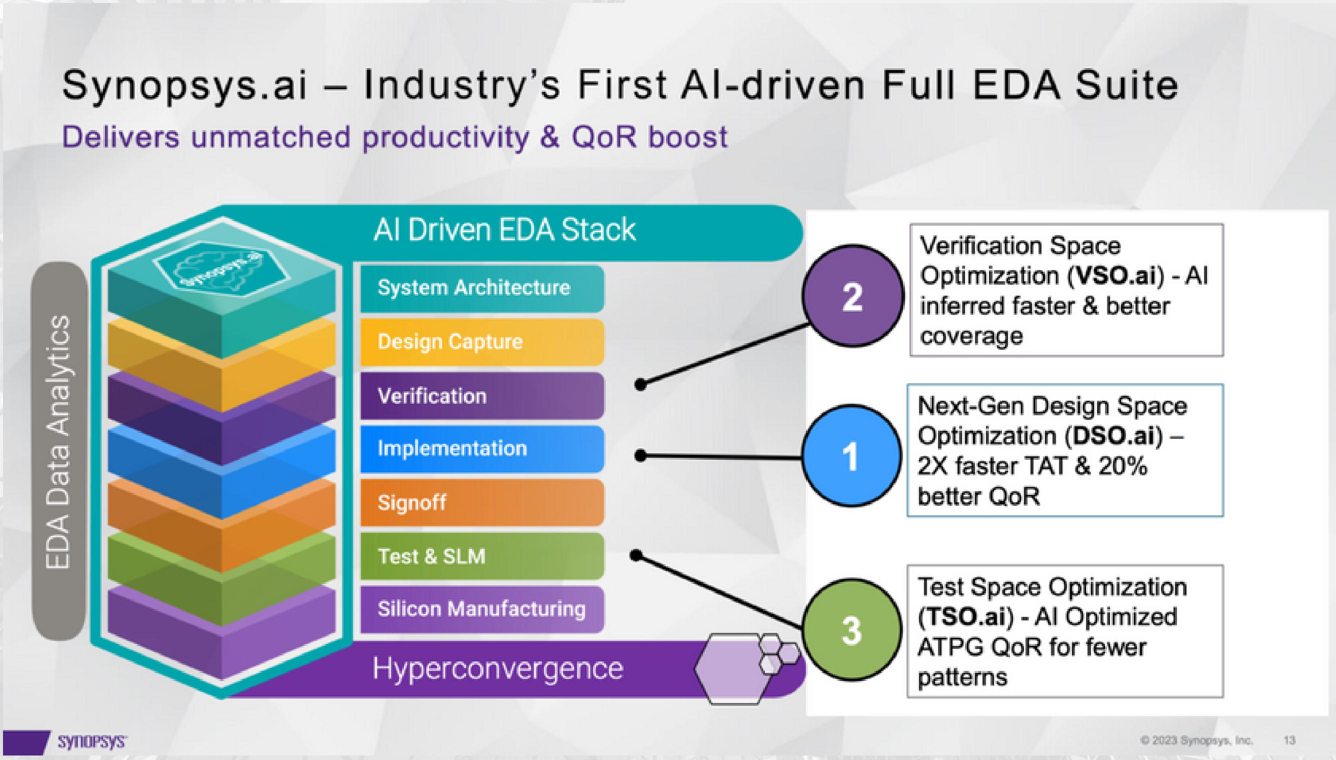
1. Efforts began as early as 2017 when the company decided to harness artificial intelligence (AI) for its entire design sub-flows and started to invest in DSO.ai or design space optimisation.

2. DSO.ai rapidly progressed from prototype to customer validation of AI-driven results in 2019, helping customers design chips with better speed and power utilisation.

3. The results don't lie. At the end of 2022, nine out of the top 10 semiconductor vendors have moved forward with its DSO.ai solution, producing 100 AI-driven commercial tape-outs. Today, this figure has jumped to well over 200.

4. Synopsys is looking to capitalise on its lead by releasing the industry's first full-stack, AI-driven EDA suite called synopsys.ai. This portfolio will include DSO.ai, VSO.ai (vertical space optimisation) and TSO.ai (test space optimisation), as shown in the slide below.

5. The list of Synopsys.ai partners reads like the who's who of the semiconductor sector, namely **Nvidia** (NASDAQ: NVDA), TSMC, **MediaTek** (TPE: 2454), **Renesas** (TYO: 6723) and IBM Research.



Source: Synopsys's investor presentation

Looking ahead, there is a new area worth watching: Synopsys's collaboration with Nvidia to help overcome the physical limitations of lithography. The solution involves using Synopsys's OPC (optical proximity correction software) on Nvidia's cuLitho, its computation lithography platform.

It's early days for this endeavour.

Overall, Synopsys is a fairly easy choice as a conviction level one stock. The portfolio will be more than happy to add to our position at better valuations.

Growth Titans: Conviction Level 1

Veeva Systems (NYSE: VEEV)

Veeva is a relatively small business among the Titan class of companies.

But it is no less defensible, in our view, outlined in our November 2020 case study HERE.

While its stock has endured ups and downs over the past 29 months, the software-as-a-service (SaaS) business is humming along with little to no drama.

Key milestones of its journey so far include:

1..The launch of Veeva Data Cloud, detailed in our June 2022 update HERE, signified the growing importance of its data portfolio. This new development is in line with our expectations outlined in Lesson #11 of our Portfolio Spotlight (Cloud Computing). Industry-specific data will be highly relevant.

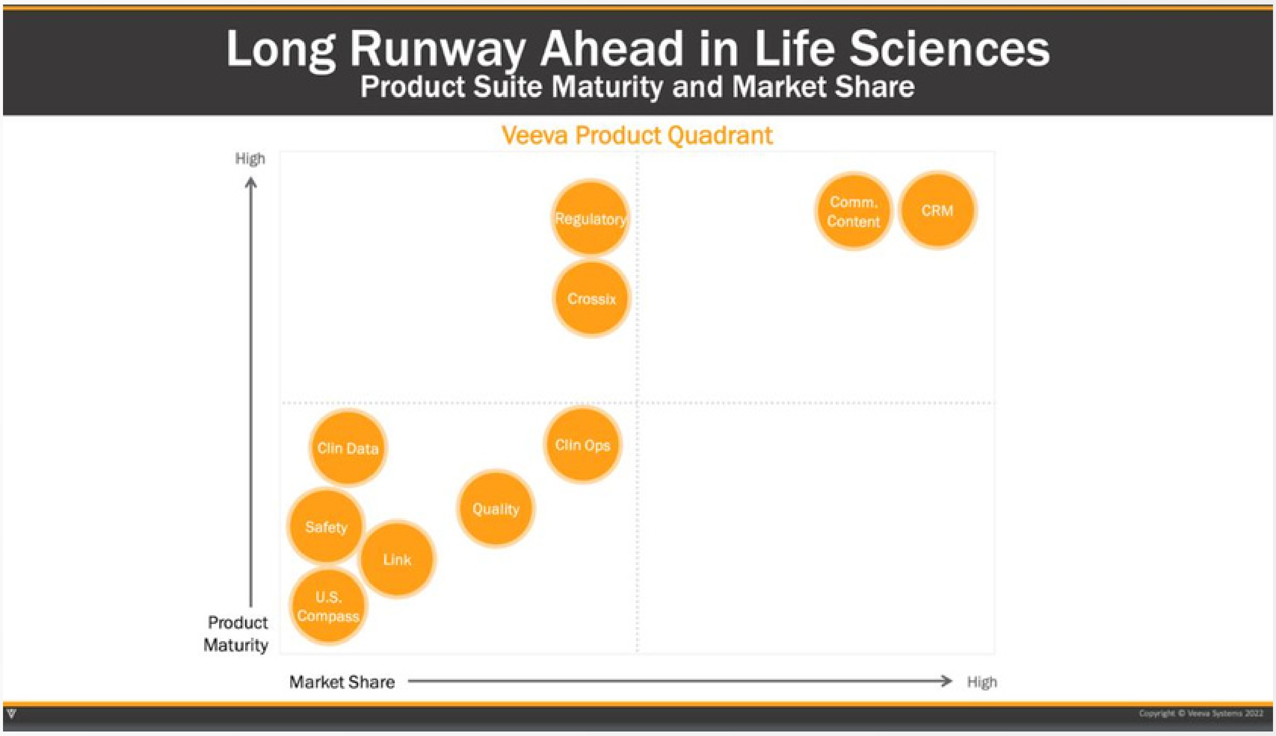
2..Veeva's November 2022 investor day HERE provided a deeper understanding of Veeva's business, including its prevalence within the pharmaceutical and biotech sectors and the inroads it has made into non-life-science areas, where it has bagged 100 customers.

3. The investor day also provided a telling overview of Veeva's product portfolio (depicted in the slide below), showcasing its valuable combination of mature, high market-share products and a plethora of emerging, high-potential products.

4. Notably, Veeva's customer relationship management solution is used by 80% of pharmaceutical reps, demonstrating its favoured position within the industry. Tellingly, Veeva CRM won 44 new customers in FY23, showing that the solution can still bring in new revenue.

5. The SaaS company's enviable position is further enhanced by pharma giant **Merck**'s (NYSE: MRK) decision to go all-in with Veeva's solutions, signing a landmark 10-year strategic partnership.

6. Looking ahead, key solutions to watch include Crossix, which comes integrated with Veeva CRM, and its Clinical Operations suite, which includes its market-leading eTMF application (electronic trial master file) and CTMS, a clinical trial management system.



Source: Veeva's November 2022 Investor Day presentation

Speaking of CRM, Veeva has finally made the decision to transition away from **Salesforce**'s CRM platform to its own in-house Vault platform.

We covered the details extensively HERE.

From everything we have read, we believe that the migration will be relatively smooth:

1. Customers will still be able to use Veeva CRM on the old Salesforces platform until September 2030 which should be more than sufficient time for the transition.

2. Veeva should be able to save around at least US$50 million per year based on its Salesforce contract which runs until September 2025.

3. Veeva's Vault already accounts for around 60% of the company's revenue. The SaaS firm is also taking plenty of measures to ensure that the change is mainly in the backend to minimise any customer learning curve.

Beyond the above, the SaaS firm will also be introducing an annual process to incorporate inflation (read: price increase) into its new and renewal orders, starting from April this year.

Customers have been receptive to the change.

Finally, we should also remind investors that founder and CEO Peter Gassner continues to be heavily invested in the success of the company. As of 31 March 2023, he owned over 14.9 million Veeva shares worth close to US$2.4 billion.
In sum, Veeva has more than earned our trust, which is why the portfolio did not hesitate to add to its position first in December 2021 and again in February 2023.

While the stock position is still not displaying a profit, we have every reason to believe that the tide will eventually turn, given Veeva's long history of generating free cash flow (FCF) and its ability to maintain a clean balance sheet with no debt.

In the short run, revenue growth will be subdued, in part due to an accounting change.

But with the impact of price increases kicking in from FY25 onwards, we believe there are better days ahead for the company, and eventually, its stock price.

Patience is all we need.

Growth Titans: Conviction Level 1

Visa (NYSE: V)

Visa is a relatively young member of the Smart All Stars portfolio with a tenure of around 10 months.

The investment thesis is still very much intact. In fact, it has strengthened, prompting the portfolio to add to its position this month.

Without a doubt, Visa is a conviction level one stock.

We covered Visa's case study extensively back in June 2022 HERE.

Here are the highlights, along with some updated figures:

Network and scale: For the fiscal year ended 30 September 2022 (FY22), Visa had 4.1 billion cards worldwide, hosting over 100 million merchant locations and more than 14,800 financial institutions in over 200 countries and territories. The payment network handled almost 260 billion transactions worth US$14.1 trillion (with a "t").

Such a scale and reach is hard to resist.

As we pointed out in our Portfolio Spotlight (Fintech) Lesson #4 HERE, almost every major fintech player or traditional bank across different regions has a partnership with credit card issuers which benefits Visa.

Over the past 10 months, we have shared specific examples including:

1. Visa's partnership renewal with China's latest credit card issuer, the **Industrial and Commercial Bank of China** (ICBC, SEHK: 1398) or ICBC along with new agreements with **China Construction Bank** (SHA: 601939), **Bank of Communications** (SHA: 601328) and **Shanghai Pudong Development Bank** (SHA: 600000), a trio of leading banks in the Middle Kingdom.

2. There were also key renewals with **UBS** (NYSE: UBS), Switzerland's largest issuer, National Bank of Kuwait, the Middle Eastern country's largest bank, and Abu Dhabi Islamic Bank, UAE's largest issuer.

3. Over in the US, the payment network operator has also renewed its wide-ranging partnership with **Bank of America** (NYSE: BAC) and **Capital One** (NYSE: COF) which are among the top four credit card issuers in the country.

4. **Block**'s (NYSE: SQ) Cash App Card, powered by Visa, is responsible for half of all inflows onto the former's Cash App platform, demonstrating the latter's importance.

5. Meanwhile, **PayPal** (NASDAQ: PYPL) will use Visa Direct for Xoom customers to send money directly to an eligible Visa debit card. New deals were also signed with **Adyen** (PTC: ADYEY) and Stripe for card issuances. The trio represent three major players within the fintech world.

Free cash flow (FCF) generator: Visa is one of the low-stress companies to follow within the portfolio, given its wide moat and reliable FCF generation.

Indeed, in the 10 months since the Smart All Stars Portfolio owned its shares, its trailing 12-months (TTM) FCF has grown from US$15.3 billion back in June 2023 to US$18.2 billion as of 2Q'FY23. This growth provides solid backing for its valuation.

New flow expansion: Looking ahead, Visa has been busy signing deals and finding new ways to tap on a potential US$185 trillion total addressable market for new flows (see our case study for more details):

1. The payment network boasted a business-to-business (B2B) payment flow of almost US$1.5 trillion in FY22, up 30% year on year. B2B is the largest addressable market worth US$120 trillion.

2. Visa Direct, a global, real-time push payment system, recorded 5.9 billion transactions in FY22. This unique network, which connects with non-Visa-owned networks, has a potential reach of seven billion endpoints, utilising 66 ACH (automated clearing houses) networks, 11 RTP (real-time transport protocol) networks, 16 card-based networks and five gateways.

3. On this note, Tap to Ride transactions (think: using Visa for your MRT ride) exceeded one billion in FY22, up 70% year on year. For 1H'FY23, these transactions have already exceeded 745 million and are on track to beat FY'22's level. Tap to Ride is enabled in over 650 transit systems around the world.

Value-added services: Before we close, there are three key areas to watch:

1..For FY22, Visa's value-added services segment pulled in US$6 billion in revenue.

2. The company's acquisition of Tink, an open banking platform, integrated with over 3,400 banks and financial institutions, could provide an interesting new source of revenue for this segment.

3. Debit processing services (DPS), an open platform which provides client acces to Visa's payment technology, hit a new milestone with US$2 trillion authorised in FY22.

4. Visa's Cybersource, a one-stop platform for payments, fraud management and data security, handled 32 billion transactions worth US$691 billion in 2021.

Growth Titans: Conviction Level 2

American Tower (NYSE: AMT)

Back in October 2021, we said if you look up the word "reliable" in the investor's dictionary, you may find American Tower.

We stand by this statement, and here's why:

1..The real estate investment trust (REIT) owns telco towers with highly favourable leasing agreements which include initial non-cancellable terms spanning five to 10 years.

2. There are a lack of alternatives to what the REIT provides, especially in the US.

3. Switching cost is also high – if the REIT's customers were to shift away from its towers, they risk disrupting their services.

In short, when it comes to revenue predictability, the factors above are as close as you can get to an ironclad guarantee.

Case in point: 90% of its US revenue and revenue growth, the REIT's largest revenue contributor, in 2023 has been fully contracted with the bulk of its revenue stream up till 2027 also under contract.

Yet, despite the clear positives, the REIT may be struggling to produce enough growth.

To put things into context, American Tower has five ways of increasing its topline, as we outlined in our case study HERE:

1..Benefit from annual rental escalations

2. Increasing the number of tenants per tower

3. Adding new towers by acquisition

4. Building new towers

5. Expansion into adjacent areas

The first two factors, in our view, can deliver somewhere in the region of 5% to 8% growth. To carry the increase to over 10% growth per year, acquisitions need to come into play.

On this note, American Tower has made an interesting adjacent expansion by acquiring data centre owner Coresite which we covered extensively HERE.

Yet, the cracks have started to show:

1. In India, where the REIT has close to 78,300 towers, American Tower has run into persistent problems. First, there was elevated churn from telco consolidation which we highlighted in our risk section HERE. Then, there was non-payment by a key customer, Vodafone Idea (VIL). As a result, the REIT appears to have thrown in the towel by looking to sell off part of its Indian subsidiary.

2. Next, the timing of the Coresite acquisition in December 2021 took us by surprise. With the benefit of hindsight, taking on more debt just as the US Fed was about to aggressively increase interest rates was not the best move.

3. As the higher interest rate started to bite into profits, American Tower decided to focus on lowering its leverage. To aid the process, the REIT decided to sell its underperforming Mexico fibre business in 2023's first quarter (1Q'23).

4. At the same time, elevated interest rates have raised the hurdle for an adequate return from acquisitions. In our October 2021 Specific Allocation Plan HERE, we said that good, large acquisition deals may be sporadic too.

5. At the moment, the management team is unable to find any compelling acquisition target and will be focused on lowering its leverage and reducing its floating rate exposure.

6. Finally, as we said during our March 2023 update HERE, the REIT expects its adjusted funds from operations (AFFO) per share to be down slightly for the year.

At this point, it's important for us to be clear.

American Tower is as reliable as they come when it comes to predictable revenue. That's great if you are looking for dividends.

But the Smart All Stars Portfolio is about growth.

As such, our conviction level for the REIT is two, owing to its insufficient growth. To set the right expectations, our future options for American Tower include:

1. The REIT is not the first choice to add until it demonstrates that it can return to higher growth.

2. If the portfolio decides to add, it will be demanding a very good value point (read: cheap). In the absence of adequate growth, valuation multiples will have to do some heavy lifting. We said the same thing in our October 2021 Specific Allocation Plan HERE.

3. Selling the REIT if we find a much better opportunity to deploy our cash or reallocate our capital.

Growth Titans: Conviction Level 2

PayPal (NASDAQ: PYPL)

PayPal has had its ups and downs since making its debut in the Smart All Stars Portfolio almost three years ago in August 2020.

There was no question that the payment provider was a beneficiary at the onset of the pandemic.

Yet, in recent times, PayPal is starting to face some headwinds.

Firstly, **eBay** (NASDAQ: EBAY) started phasing out PayPal as its primary payment provider in 2021's third quarter (3Q'21).

For context, eBay was instrumental in helping PayPal scale up as we highlighted in our Portfolio Spotlight (Fintech) HERE. But eBay's contribution has since dwindled to less than 4% of PayPal's total revenue by the time the transition started.

Nevertheless, the exit did cause a temporary drag on revenue growth.

Meanwhile, normalising eCommerce growth and a weakening macroeconomic environment have also dampened its growth momentum.

Amid the slowdown, two risk factors we highlighted in our case study HERE have flared up:

1. Firstly, intense competition appeared to chip away at PayPal's core checkout business.

2. Secondly, the company has faced criticism for overpaying for its acquisitions.

The reasons above provide insight into why the portfolio's conviction level is at two.

Notably, these challenges have forced PayPal to rethink its priorities, as we highlighted in August 2022 HERE. CEO Dan Schulman Schulman listed key actions the company will be taking:

1..Doubling down on its areas of strength, namely checkout, digital wallets and Braintree.

2. Pare down its operating cost by at least US$1.3 billion in 2023.

3. Refreshing its management team, including hiring a new CFO (Blake Jorgensen), shifting its current CFO to a treasurer role, and promoting talent to take over its consumer business (Doug Bland).

4. In addition, PayPal pledged to avoid fringe acquisitions and focus on its core competency.

Of course, as the company makes progress in the areas above, CEO Dan Schulman's decision to step down has introduced uncertainty.

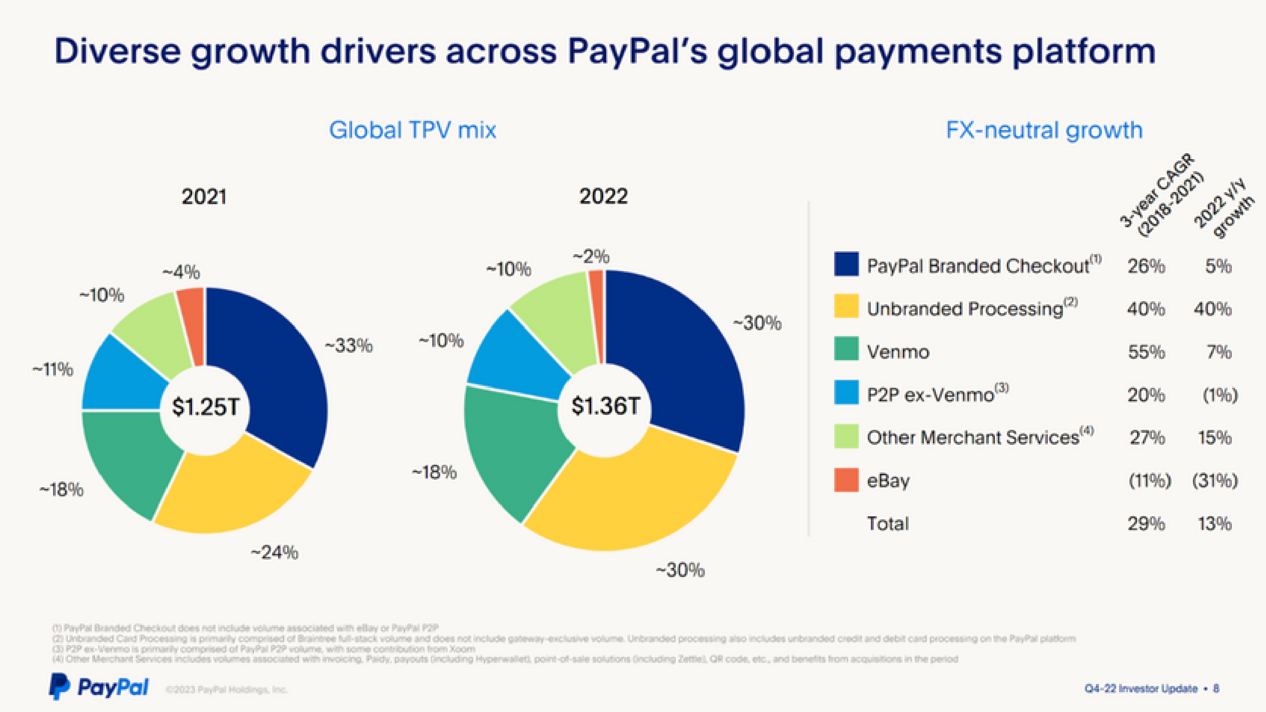
Given its challenges, we believe that leadership is key to its future success. Despite the many headwinds, our growth mindset demands that the negatives should not overshadow the positives and PayPal's potential:

1. **Network strength**: Within three years, the fintech firm's network grew from 325 million active accounts (including 25 million merchant accounts) in 1Q'20 to 433 million in 1Q'23 (including 35 million merchant accounts).

A key part of its value also comes from the two-sided network.

PayPal owns Venmo which is sizable in its own right, generating US$63 billion in total payment volume in 1Q'23 or over US$250 billion if annualised.

2. **Total payment volume (TPV)**: PayPal has also diversified its global TPV mix where branded checkout (30% of 2022's total TPV), unbranded processing (30%), and Venmo (18%) stand out as major contributors, as shown in the slide below.
For 2022, the company processed US$1.36 trillion of payments, an enviable scale that only a handful of competitors can match or exceed.



Source: PayPal's earnings presentation

3. **Unbranded processing**: This segment has been a bright spot among its TPV mix, growing substantially faster than the rest.
Unbranded processing has lower margins, but PayPal will be focusing on substantially improving the margin structure by introducing value-added services such as risk-as-a-service, Fx-as-a-service, and full omnichannel capabilities.

The introduction of the new PayPal Complete Payments Platform (PCPP) in 4Q'22 also opens up a new US$750 billion total addressable market in the small to medium business segment and comes with higher margins.
In addition, CEO Dan Schulman added that the data generated by PCPP will be a valuable source of data to power its AI engines.

4. **Buy Now Pay Later (BNPL)**: PayPal's BNPL solution, introduced back in August 2020 or less than three years ago, has been a revelation.
In 1Q'23, Schulman said that over 32 million consumers have used PayPal's BNPL at almost three million merchants, making it one of the most popular BNPL options in the world. TPV for this segment came in at a solid US$6 billion.

BNPL has also emerged as a key driver in helping PayPal enhance its checkout value proposition for merchants, adding incremental revenue.
This success makes the good case that PayPal is able to tap on its established network to introduce new services.

5. **Signs of life in eCommerce**: As we shared back in February 2023 HERE, PayPal's revenue growth is highly dependent on the health of discretionary e-commerce spending.

In 1Q'23, PayPal saw some signs of life.

We could be at the early stages of recovery as key e-Commerce players namely **Shopify** (NYSE: SHOP) and **Amazon** (NASDAQ: AMZN) have also reported better than expected numbers over the same period.

While e-Commerce growth normalised in 2022, we have maintained that normalisation is a return to the previous growth trajectory, not a flattening of sales growth forever.

6. **Free cash flow**: Finally, PayPal continues to be a cash flow generative company. In 2023, the company expects to produce US$5 billion in free cash flow.

Being a self-sufficient business in tough operating environments is definitely a big plus.

Setting the right expectations

Before we close, the Smart All Stars Portfolio acknowledges that it has added PayPal twice in February 2022 and December 2022.

In both cases, a key reason has been valuation.

For the returns to be satisfactory, we need to see a return to higher growth.

At the moment, the portfolio thinks it is prudent to place PayPal at conviction level two.

Consistent with the portfolio's strategy to add in stages, as highlights in Lesson #6 HERE, we have to see signs of sustainable growth before the portfolio increases its allocation further.

June 2023

GROWTH LEADERS

Atlassian
Doximity
lululemon
MarketAxess
MercadoLibre
ServiceNow
Shopify
Tractor Supply
Block
Netflix
DocuSign
Illumina
Roblox
Zoom

Growth Leaders: Conviction Level 1

Atlassian (NASDAQ: TEAM)

Atlassian was one of the pair of stocks that debuted together with the Smart All Stars Portfolio.

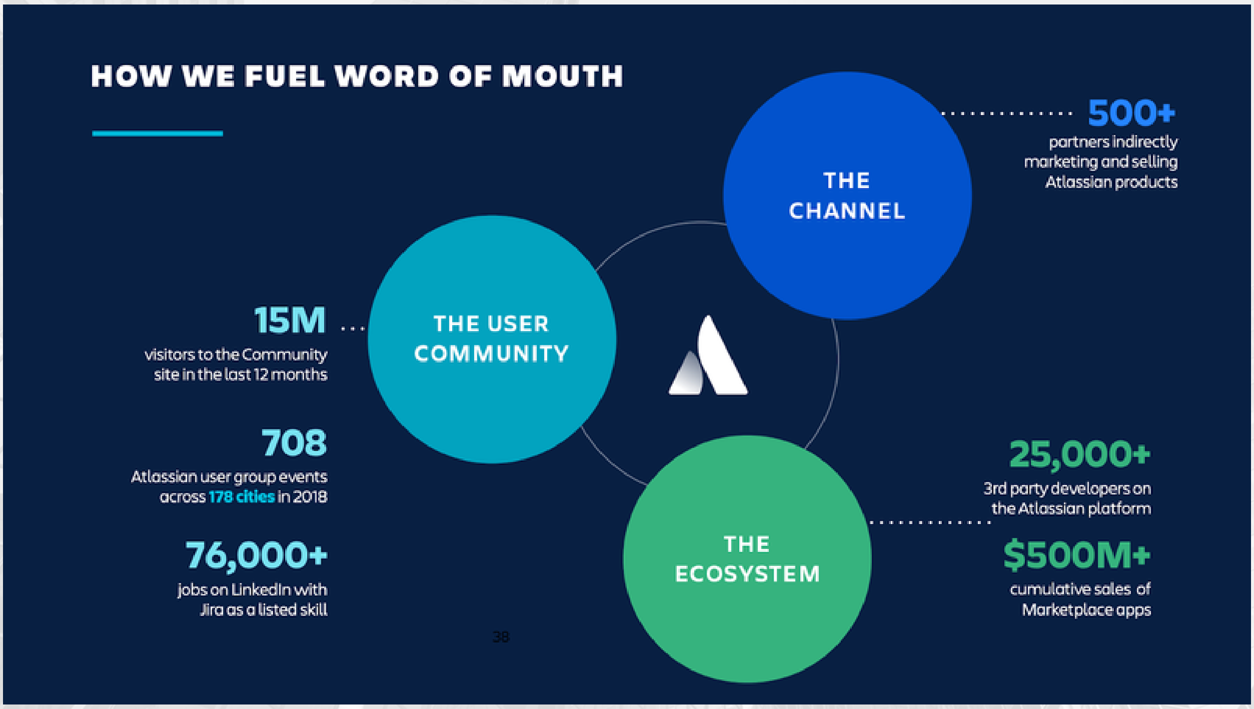
If we were to capture the Aussie firm's special sauce in a single sentence, it would be ...

"Software should be bought, and not sold"

The entire company is built on this mantra, choosing to spend relatively little on marketing while investing heavily in product development. The end goal is to create high-quality, easy-to-use software which can be used within minutes.

It's not just a feel-good motto.

As word of mouth spread, Atlassian's ecosystem of partners, customers and developers exploded upwards, providing a steady stream of potential prospects for the firm, as we shared in our original May 2020 case study HERE.



Source: Atlassian's April 2019 Investor Day presentation

Given the low cost of acquiring new customers, it's no wonder the business is able to turn every dollar of revenue into US$0.35 of free cash flow (FCF).

We're not the only admirers.

Recently, **DocuSign** (NASDAQ: DOCU) hired ex-Atlassian Chief Marketing Officer Robert Chatwani to lead DocuSign's go-to-market strategy. In the announcement, DocuSign made no secret of its admiration for the Aussie firm's business model.

For Atlassian, the firm hit a turning point in November 2020, when it decided to go all-in into becoming a cloud platform, as we shared HERE:

1. At the time of the announcement, Atlassian already had a cloud platform which was used by 85% of its clients.

2. Instead of burning both ends of the candle, the Aussie firm fully committed to its cloud platform by defining clear cut-off dates for supporting non-cloud services.

3. To ease the transition pain, a three-year plan was mapped out.

Fast forward to today, we can say with certainty that Atlassian's bold move is working out.

As we covered in our May 2022 update HERE, the migration had unexpected benefits.

For starters, the company's cloud platform has been rebuilt from the ground up, creating a common platform for its infrastructure and shared services, and data management.

Having such a platform is highly desirable, as we have seen at fellow Growth Leader **ServiceNow** (NYSE: NOW).

With a common platform, new products can be introduced faster, cheaper, and with less friction.

Best of all, these advantages are in-built which will continue to benefit Atlassian for the long term.

Speaking of products, Atlassian is stepping on the accelerator pedal to consolidate its position:

1. **Open DevOps**: Open DevOps is the company's way of providing its customers with a way to customise their toolchains with the best-of-breed products. Customised solutions will likely lead to better retention, in our view.

2. **IT Service Management**: Atlassian is also tapping on its core developer base to create platforms for developers and IT teams to work together. It's the Aussie company's answer to the ServiceNow platform.

3. **Work Management**: If we extend the idea to helping departments connect with one another, we have Work Management, aimed at becoming the bridge between technical and non-technical teams.

The early signs are positive.

In Atlassian's third-quarter report for the fiscal year ending 30 June 2023 (3Q'FY23), the Jira Work Management customer base grew 50% year on year with monthly active users increasing by over 80% compared to a year ago.

Supplementing the three focus areas above would be Atlassian's vibrant marketplace for apps.

In 3Q'FY23, the Aussie firm shared some compelling statistics:

1. There are over 5,300 apps and more than 1,700 independent developers and Marketplace Partners who earn a living on the Atlassian marketplace.

2. The app market platform recently surpassed US$3 billion in lifetime sales, up from US$2 billion a little over a year ago. For context, it took almost seven years to reach the first billion in sales, indicating that these gains are accelerating. The majority of these earnings go to its third-party developers.

3. As we shared back in May 2022, at least 70% of Jira and Confluence Cloud customers use one app.

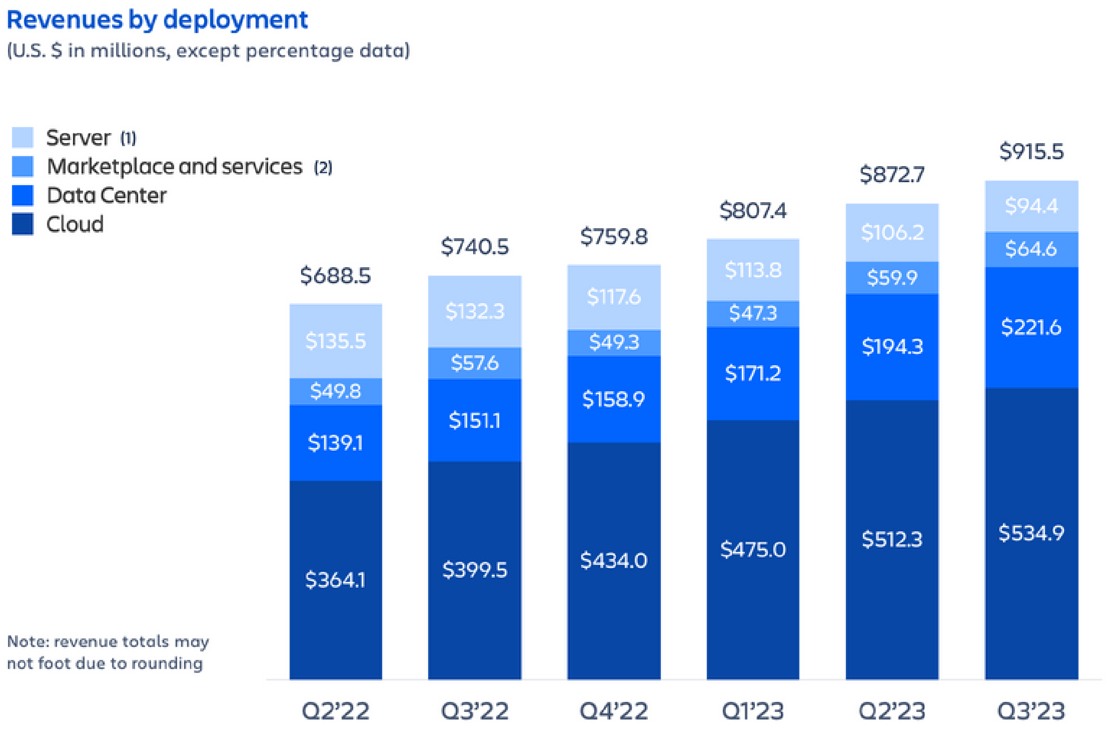
Beyond the marketplace, Atlassian has also introduced two new solutions worth watching:

1. The firm launched Beacon, a data security solution for customers to detect, investigate, and address risky and suspicious behaviour across the firm's products.

2. Atlassian has also partnered with OpenAI to launch Atlassian Intelligence, combining machine learning models with OpenAI's technology. Users will soon be able to automate tasks such as assigning tasks, creating meeting transcripts, writing marketing copies, and converting questions into Jira Query language.

To be sure, there is a minor wrinkle to the story.

Atlassian may have gotten ahead of itself when it projected that its cloud revenue would grow 50% year on year for the fiscal year ending 30 June 2023 (FY2023) and FY2024.



Year-over-year growth %	Q2'22	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23
Cloud	58%	60%	55%	49%	41%	34%
Data Center	83%	59%	60%	54%	40%	47%
Marketplace and services	20%	(4%)	24%	4%	20%	12%
Server	(12%)	(19%)	(16%)	(18%)	(22%)	(29%)
Total revenues	37%	30%	36%	31%	27%	24%

Source: Atlassian's 3QFY23 shareholder letter

The Aussie company has since backed down from its lofty goal:

1..In 3Q'FY23, Atlassian cloud revenue accounted for 58.4% of the quarter's topline, as shown in the graph below. The firm updated its cloud revenue growth projection to 37% year-on-year for FY23, after lowering its guidance in 1Q'FY23.

2. Cloud revenue growth has slowed amid lower free-to-paid conversions, modest seat count reductions from customers due to layoffs and slower paid seat expansion from its existing customer base. Despite the challenges, we still think 37% growth is very healthy.

3. More importantly, there is no sign of higher churn, and interest in the company's products remains strong. In short, the opportunity is there for Atlassian to capitalise.

4. As a reminder, Server revenue will continue to decline as it approaches end-of-life in February 2024. Atlassian continues to work on migrating the remaining customers to its data centre or cloud services.

In short, all of Atlassian's advantages are intact while its migration into becoming a cloud platform has strengthened its position.

For these reasons, the business wins a Conviction Level 1 status.

Growth Leaders: Conviction Level 1

Doximity (NYSE: DOCS)

Doximity is a relative youngster in the portfolio, having made its debut back in November 2021.

Simply said, all of the factors that attracted us to its business 1.5 years ago are still present:

Firstly, Doximity continues to be the "go-to" platform for 80% of US physicians.

With a strong network of medical professionals, the company's ability to land and expand new customers remains strong.

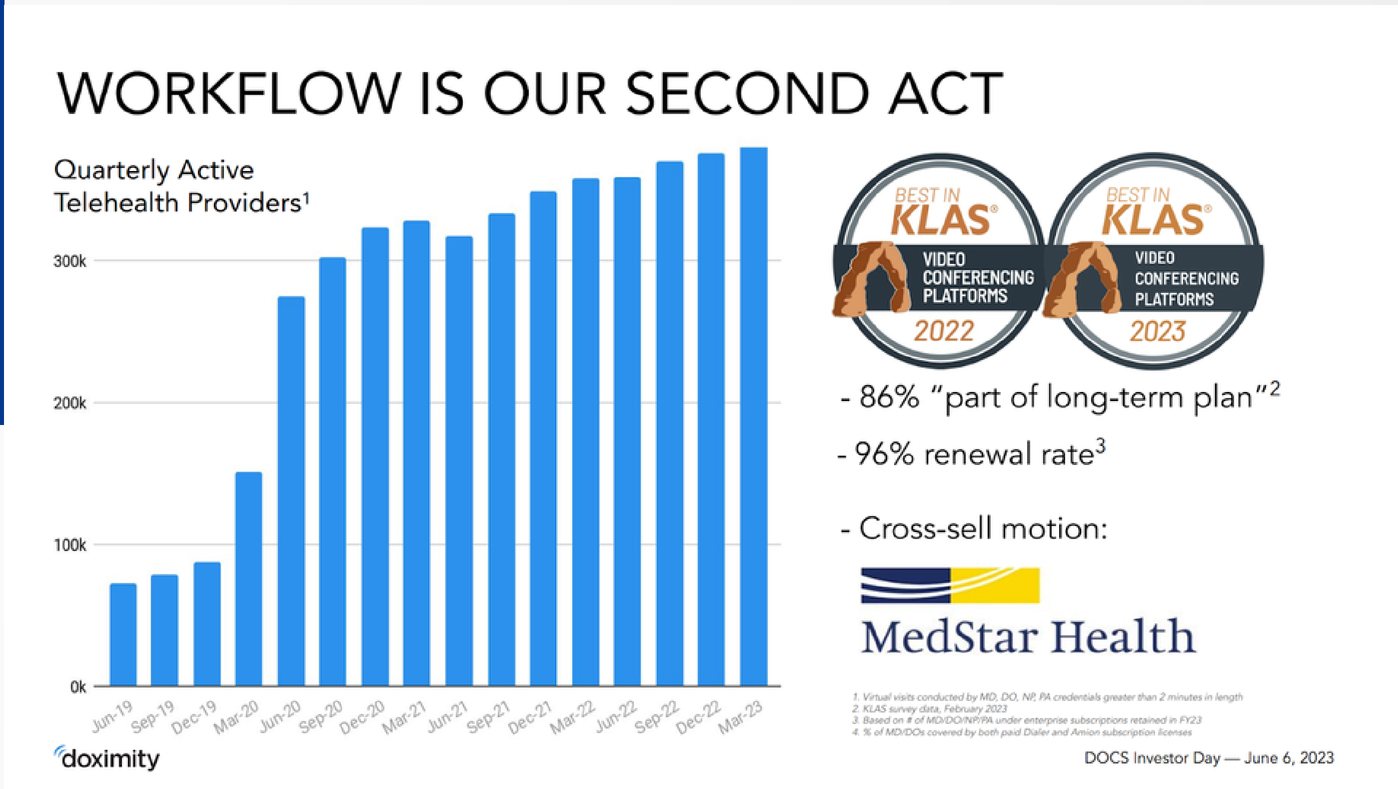
1. All of the Top 20 Hospitals and Top 20 Pharmaceutical manufacturers are Doximity customers, signifying the importance of its platform.

2. In its fourth quarter of the fiscal year ending 31 March 2023 (4Q'23), there were 294 customers contributing at least US$100,000 each in subscription-based revenue, up 16% from a year ago. Furthermore, there are 11 customers spending over US$10,000,000 on its platform in FY23.

3. Financially, Doximity has one of the best FCF profiles out there, clocking over US$419 million in revenue for FY23 and generating an FCF of US$173.4 million or a pleasing 41.4% FCF margin.

4. The balance sheet is as strong as ever, holding US$841 million in cash, cash equivalents and marketable securities with zero debt.

The most exciting development, in our eyes, is Doximity's declaration that Workflow will be its second act, as shown in the slide on the next page.



Source: Doximity's June 2023 Investor Day presentation

As we shared in our November 2021 case study HERE (bolded for emphasis):

"We'll be looking to Doximity to add new revenue streams, akin the telehealth initiative, in the future.

For the SaaS company to be a wildly successful investment, we believe that it will have to transform into a platform where "multiple futures" can be built."

We are seeing positive signs that the company's business will not just be about being a platform for pharmaceutical companies to market their product.

Instead, Doximity has been methodically building on its success with telehealth and working in new workflow services to help reduce the administrative load for doctors:

1. Telehealth tools remain highly popular post-pandemic, clocking a new record of 380,000 unique providers (a term used to refer to medical professionals). These tools are now integrated with three of the largest electronic health record (EHR) providers, covering 85% of the hospital market.

2. Doximity acquired Amion, a scheduling service, enabling the company to integrate 200,000 physician schedules into its growing productivity suite. This service, along with dialer, will form the cornerstone of Doximity's daily physician workflow; this is a strong hint of where Doximity intends to position itself.

3. DocsGPT, created together with OpenAI, is helping doctors with administrative tasks such as drafting appeals and authorisation letters.

In sum, Doximity is keen to reposition itself as the Bloomberg of the physician world rather than just being seen as a Linkedin service.

So what should we expect in the future?

During its June 2023 Investor Day, the firm has set itself a target of hitting US$1 billion by FY28, implying a 20% per year topline growth from FY23.

In the short term, Doximity is facing some headwinds from slower upsells which has left its net retention ratio falling from 157% in 4Q'FY22 to 117% in 4Q'FY23.

Over the long term, though, we continue to like where the company is positioned, and the progress it is showing in building its second act. The stock price has not lived up to its promise yet, but over time, if its FCF can grow, then the stock price will follow.

For us, Doximity's advantages remain intact while the traction on its second act as a workflow provider looks promising, earning it a Conviction Level 1 rating.

Growth Leaders: Conviction Level 1

lululemon (NASDAQ: LULU)

lululemon has been making a habit of beating expectations since CEO Calvin McDonald took over.

Despite the onset of the pandemic, the company managed to exceed its April 2019 Investor Day financial targets two years ahead of time, doubling its men's and digital revenue while quadrupling its international sales within three years instead of five.

For details, check out our September 2021 case study HERE on the Power of Three.

Given its progress, McDonald doubled down during its April 2022 Investor Day, setting a new course to double men's and digital sales again while increasing international revenue by another fourfold, all within the next five years.

The two statements above are sufficient to tell you that the business is humming along nicely.

A peek into its recent fiscal year 2023's first quarter (1Q'FY23) results show that the apparel retailer continues to deliver the goods, clocking revenue growth of 24% year on year to US$2 billion.

1. Men's products accounted for almost 22% of overall sales while international sales had risen to account for more than a third of the quarter's revenue.

2. lululemon's direct-to-consumer (DTC) approach continues to showcase its strength in both offline and online channels, delivering a pleasing comparable sales growth of 16% for stores and 18% for e-commerce.

3. High inventory growth, which caused FCF to decline in the near term, has since corrected itself and is now increasing at the same rate as its revenue.

The company's strong FCF generation in 4Q'FY22 was a signal to the end of its inventory issues, prompting the Smart All Stars Portfolio to increase its position in April 2023.

To be sure, lululemon did suffer a black eye from the huge write-down of its US$500 million MIRROR acquisition.

More details can be found HERE.

All in all, the business performance has far outweighed the hiccups along the way, earning lululemon a Conviction Level 1 status.

Growth Leaders: Conviction Level 1

MarketAxess (NASDAQ: MKTX)

The premise behind MarketAxess is fairly straightforward.

It is essentially a fixed-income marketplace to connect buyers and sellers.

Furthermore, the key ingredients to success are not hard to understand:

1. You need to have enough interested parties transacting on your platform to make it worthwhile to participate. The more, the merrier.

2. Trading activity has to be high enough for the existing parties to find value in remaining on its platform.

3. The types of fixed-income instruments available to trade must expand over time; otherwise, it will be relegated to niche use or even be overtaken by its competitors.

By all accounts, MarketAxess has continued to work on all three factors above throughout the Smart All Star Portfolio's ownership of the stock.

But alas, even the best efforts can be undone by factors outside its control.

By the third quarter of 2021 (3Q'21), which we covered in detail HERE, it had become obvious that MarketAxess's revenue had stalled while earnings per share (EPS) had fallen year on year.

The reason behind these unfavourable developments was not too concerning.

As a background, MarketAxess was suffering from low credit spreads and credit spread volatility. In plain English, the gap between the buying and selling price was so low that traders were no longer willing to make the transaction.

More importantly, this situation was not new.

Over time, the low spreads usually start correcting themselves and subsequently, the level of trading on the MarketAxess platform would then rise. However, what happened after 3Q'21 was abnormal.

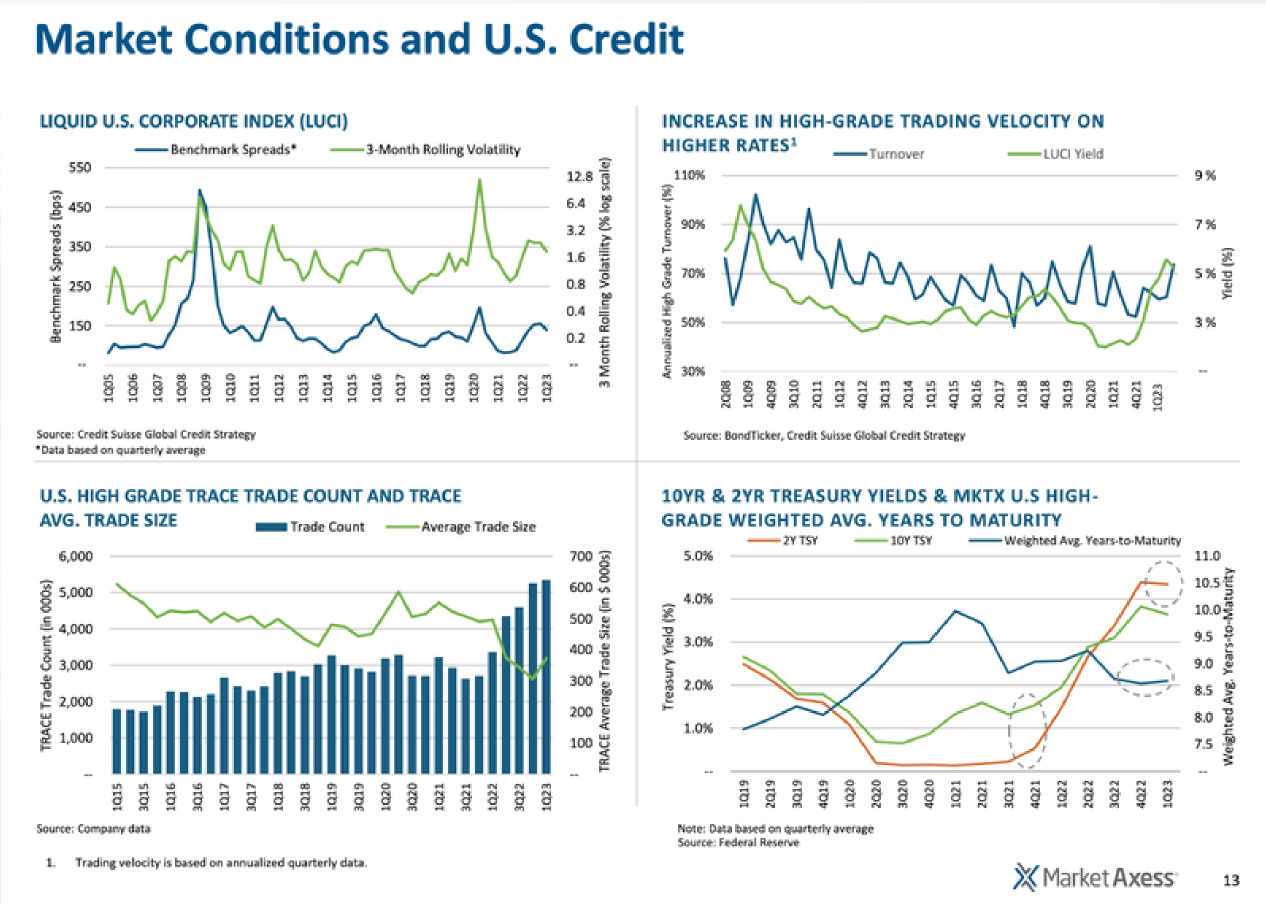
The US Federal Reserve went on a run of aggressive interest rate hikes, causing corporate bond durations to unexpectedly fall 18% year on year in 3Q'22, one of its steepest declines ever.

The result was a mixed bag, as we covered in our deep dive HERE.

As interest rates rapidly increased, MarketAxess benefited from a rise in interest for fixed-income investing and subsequently, higher trading volume. On the flip side, transaction fees, which are partly tied to bond durations, headed south, offsetting some of its volume gains.

With that, it brings us to today.

The company's latest quarter did offer a glimpse of hope that the unusual trends in the bond market may finally be ending, as the slide below shows.



Source: MarketAxess's 1Q'23 earnings presentation

Co-founder Richard McVey, who recently handed over the CEO reins to COO Christopher Concannon, sounded an optimistic note:

"The overriding theme, in my view, is the highest yield environment we have seen in over 13 years and the opportunity for global investors to reallocate assets back into fixed income.

That trend was apparent in the record high-grade TRACE [trade reporting and compliance engine] volumes in Q1, reflecting higher trading velocity.

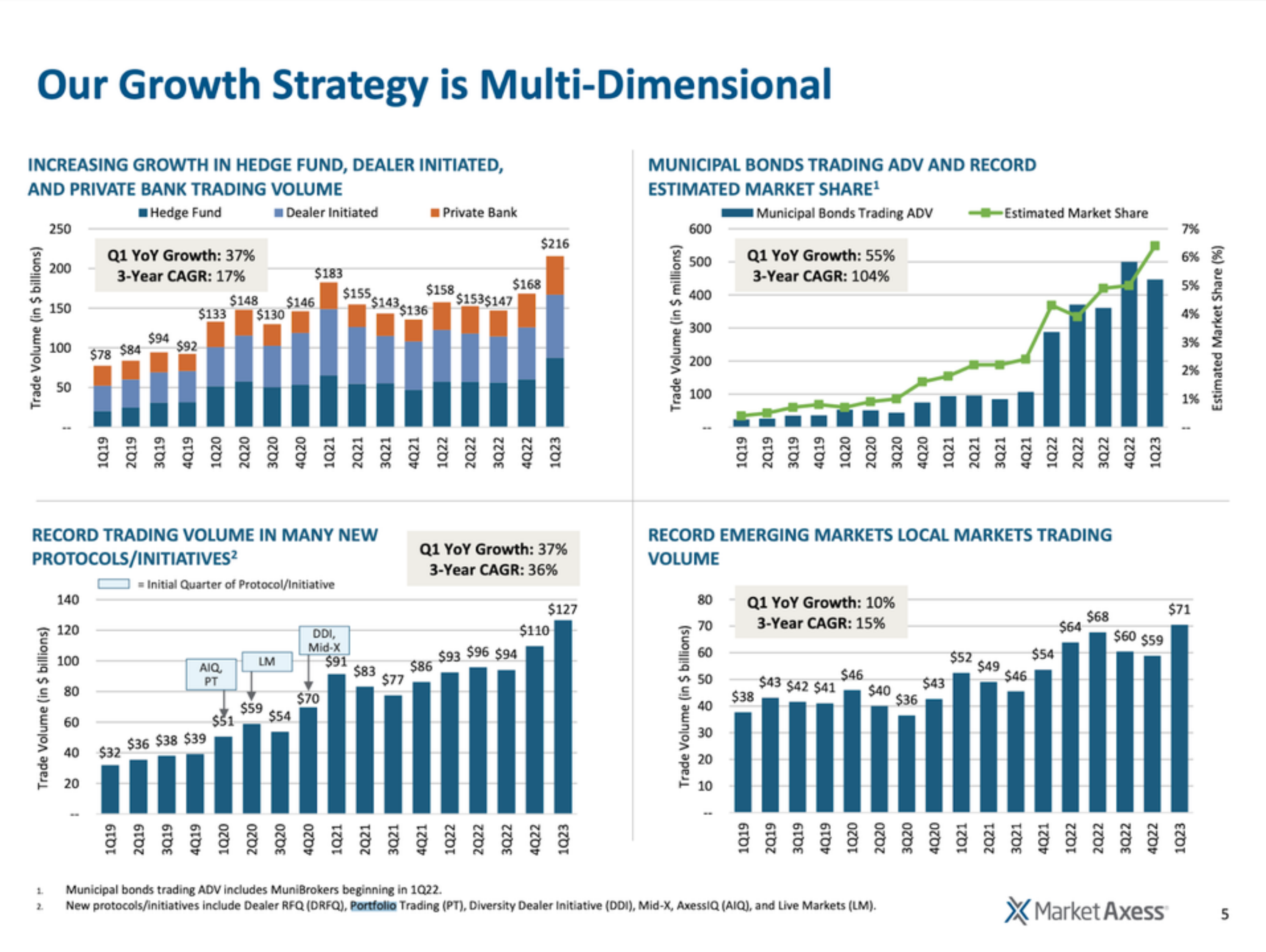
Investment-grade TRACE ticket count in Q1 grew 59% and average trade sizes declined 25% as fixed income becomes an investable asset class again and investors reenter the market.

Both retail and institutional investors are seeing higher ticket count, leading to an essential need to embrace trading automation for efficiency."

What's pleasing is MarketAxess has not skipped a beat over the years, working on new solutions (think: automation), expanding its product slate, and attracting new participants:

1. Since 2018, new products such as US treasuries, municipal bonds, ETFs, and data, were introduced. We covered part of these in our October 2020 case study HERE.

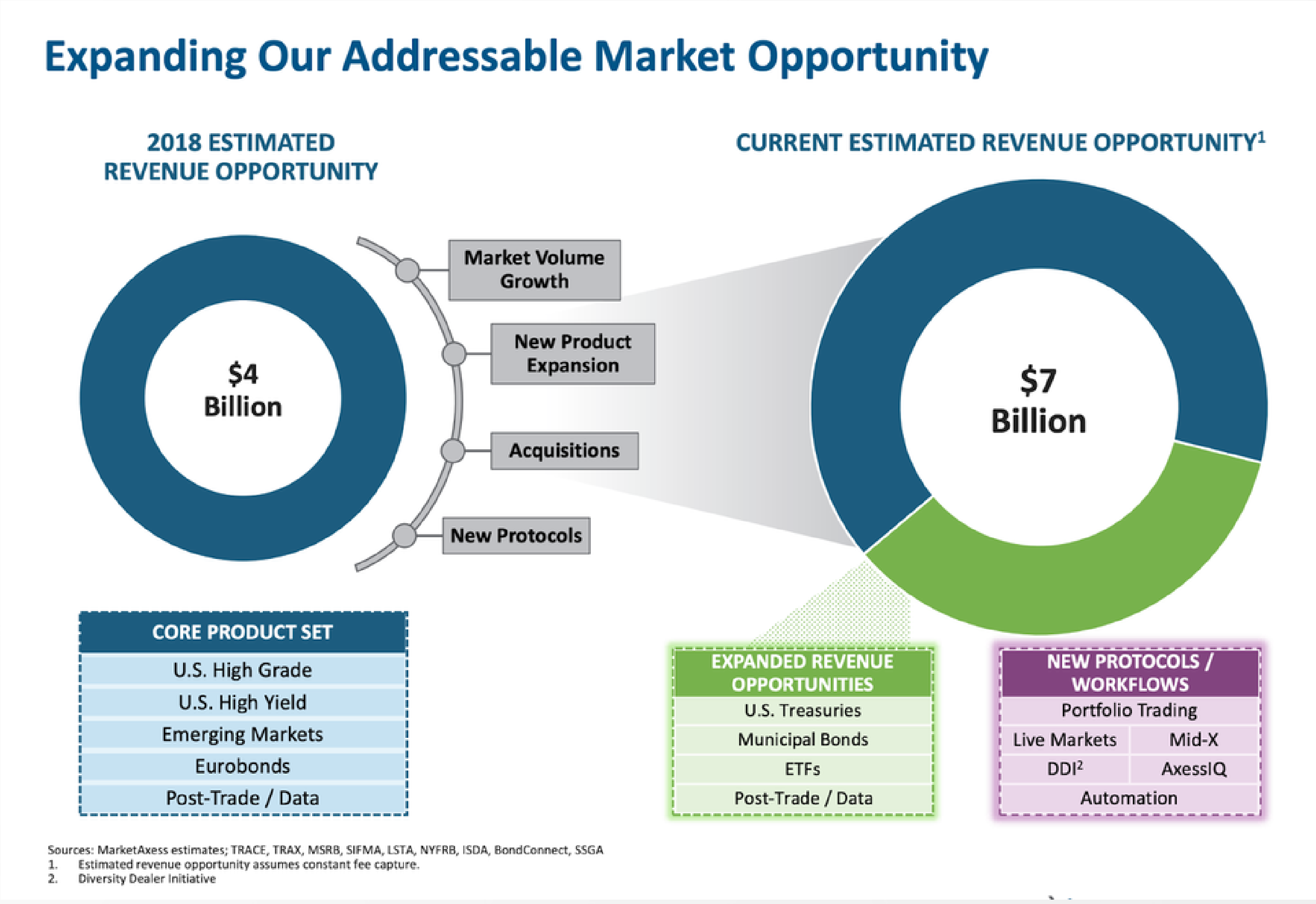
2. Initiatives, such as automated trading and portfolio trading, continue to gain traction as demonstrated in the slide below.



Source: MarketAxess's 1Q'23 earnings presentation

The end result is the company's estimated revenue opportunity increasing from US$4 billion in 2018 to US$7 billion in 1Q'23.

For context, MarketAxess generated US$735 million in revenue for its trailing 12 months (TTM), implying that it has only reached a little over 10% of its potential sales.



Source: MarketAxess's 1Q'23 earnings presentation

In sum, MarketAxess has been impacted by external factors which we deem to be unusual, but its underlying business has strengthened in our eyes.

For that, the stock gets a Conviction Level 1 rating.

Growth Leaders: Conviction Level 1

MercadoLibre (NASDAQ: MELI)

MercadoLibre is a rare bird in the eCommerce world.

Originally billed as the eBay (NASDAQ: EBAY) of Latin America, the Argentine company's operations have since been compared to the likes of Amazon (NASDAQ: AMZN).

Yet, MercadoLibre stands alone in its achievements to date.

Unlike Amazon, MercadoLibre has a thriving fintech business.

In fact, the firm's off-marketplace total payment volume (TPV) exceeds its own marketplace TPV, a rarity in the eCommerce world.

Meanwhile, as global eCommerce growth slowed post-pandemic, the Latin American firm continued to march forward to its own beat, as the statistics from its 2023 first quarter (1Q'23) proved:

1. Gross merchandise volume rose 43% year on year (in constant currency) to US$9.4 billion while TPV soared over 96% year on year to US$37 billion.

2. Penetration for Mercado Envios, its fulfilment solutions, reached 44%, a feat that even the likes of Shopify (NYSE: SHOP) are unable to emulate.

3. The firm's Mercado Credito portfolio also inched up to US$3 billion with its annualised interest margin after losses coming in at 39% while its non-performing loan (< 90 days) ratio fell to 9.5%, down from 13.4% a year ago.

4. For the first time ever, the number of unique active users exceeded the 100 million mark, opening up new opportunities for the firm.

Looking ahead, there are two areas we are watching at MercadoLibre:

Advertising: For the first time, the Latin American firm has provided more detail on its advertising push.

True to form, MercadoLibre is not short on ambition, aiming to provide solutions starting from the top funnel down to the customers' consideration stage.

Like Amazon, the Latin American eCommerce site has an unparalleled trove of first-party user data.

Between its fintech and fulfilment, we think that Mercado should be able to create a closed-loop advertising solution where advertisers will have a clear view of how their ads lead directly to a sale on MercadoLibre's marketplace.

In 1Q'23, the company also launched its programmatic platform:

"Brands and agencies now have an automated display buying platform that leverages one of our main assets: our **unparalleled first-party data**.

The depth and granularity of our data, let us build unique targeting capabilities, accurate real-time bidding models, live reports, and unique insights analysis.

Further down the funnel, we **have our performance advertising solution focused on helping sellers to increase their product's visibility in the search results and product pages**.

The **media buying process** is an auction, based on sophisticated algorithms, which **take into consideration the price the seller is willing to pay per click and also the ad's relevance**.

This enables us to guarantee a good experience to both the buyer and the seller and accomplishes the value proposition of increasing the chance of converting a click into a sale."

The last sentence is key as it shows how MercadoLibre is determined not to ruin the buyer's experience as it provides ad solutions to the sellers.

MercadoPago: As the Latin American firm expands the range of its fintech solution, it believes that it has reached a critical mass of services which will enable its users to form their principal financial services relationship with Mercado Pago.

Although the firm did not say it explicitly, we think that MercadoLibre may see itself as a wealth manager of sorts for Latin Americans.

The direction is also in line with what we shared in Lesson #4 of our Portfolio Spotlight for Fintech HERE.

Said another way, the runway is still long for our favourite eCommerce and fintech firm.

MercadoLibre's long track record of outperformance coupled with a long growth runway ahead puts it in a sweet spot where investors are able to profit alongside the firm.

For us, the reasons above make the stock a shoo-in as a Conviction Level 1 stock.

Growth Leaders: Conviction Level 1

ServiceNow (NYSE: NOW)

ServiceNow is not the most exciting company in the Growth Leader cohort.

But as demand for enterprise software waned post-pandemic, the productivity software provider showed its mettle.

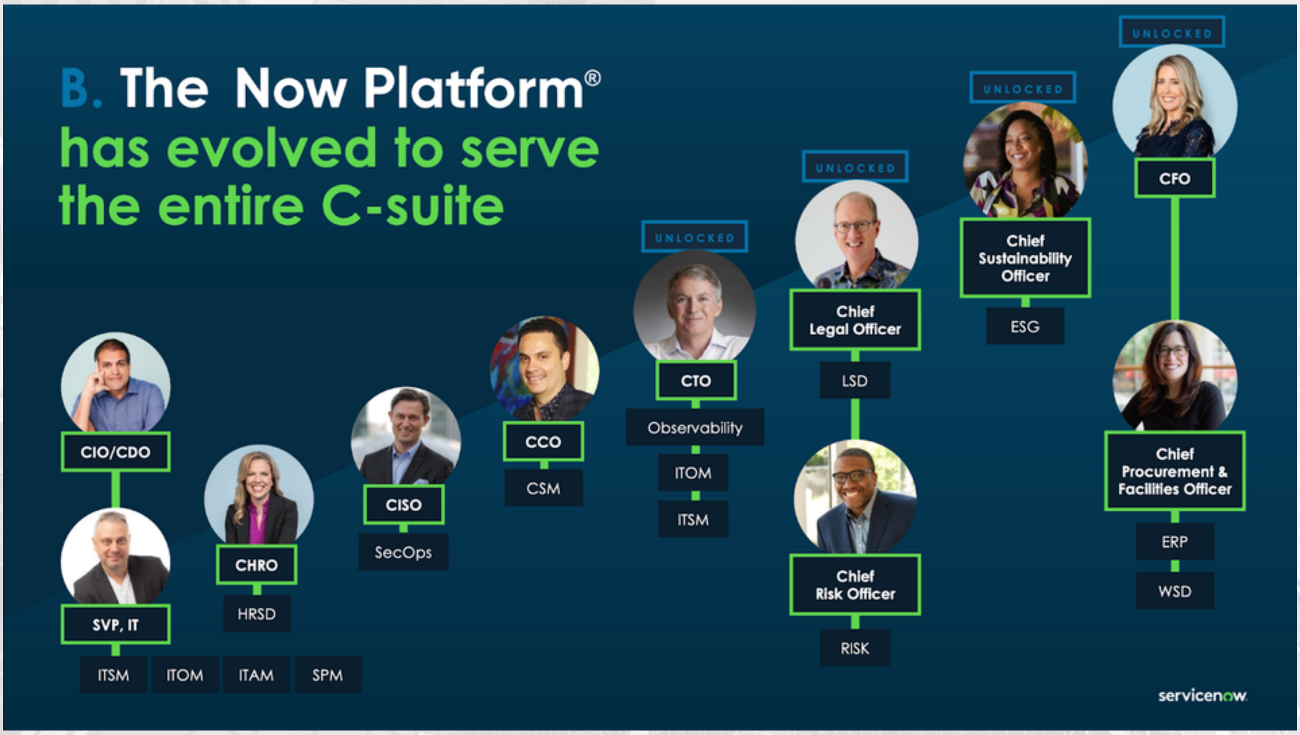
In our 2022 Year-End Review, we shared this key observation:

"In our eyes, when C-suites have their backs to their wall and **urgently need to reduce cost**, they will default to safety, **going with the tried-and-tested solutions that deliver results** as soon as possible."

ServiceNow fits like a glove in this situation.

As we highlighted in our March 2022 case study HERE, the software-as-a-service firm (SaaS) started life as an IT service management (ITSM) provider.

Today, its Now platform has been elevated to a status where it is rubbing shoulders with the entire C-suite.



Source: ServiceNow's June 2023 Investor Day

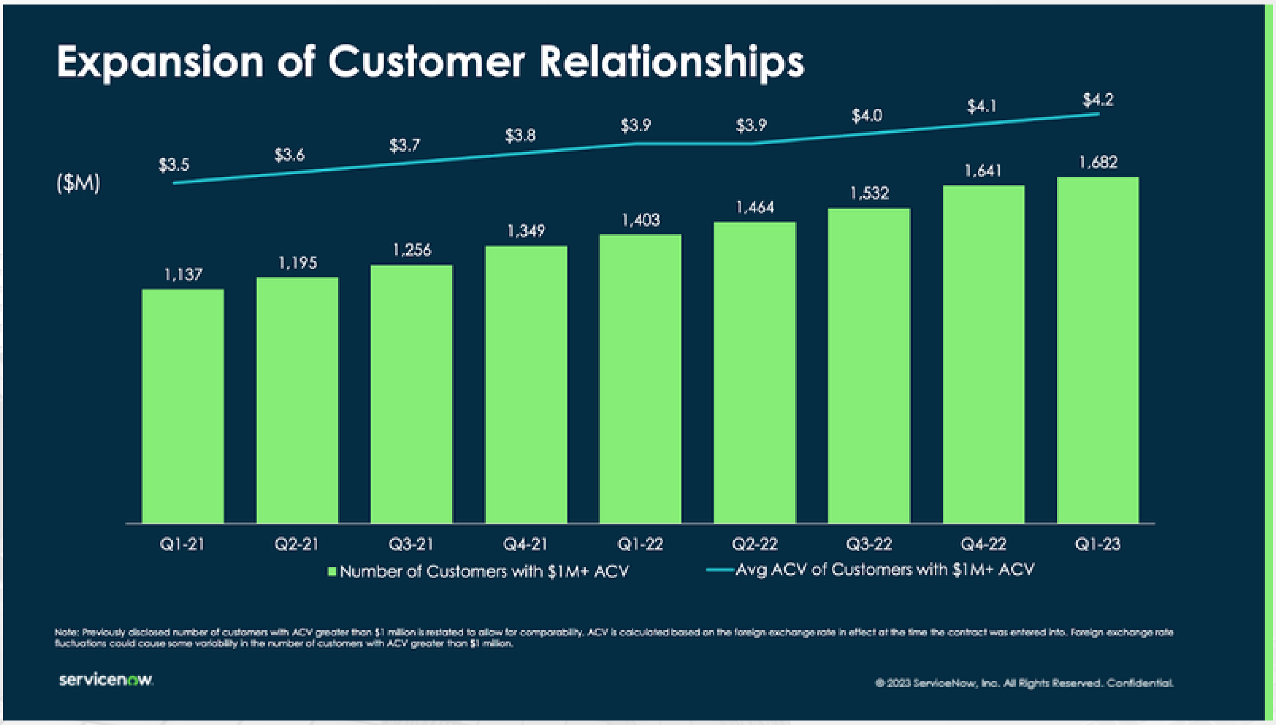
The latest statistics shared during its 1Q'23 results are another showcase of its end-to-end C-suite strength:

1. ITSM was present in 18 of its Top 20 deals, demonstrating its relevance despite being the oldest solution within ServiceNow's product portfolio.

2. In fact, looking at the Top 20 deals, 18 involved five or more products, ranging from IT Operations Management (ITOM; 14), IT Asset Management (ITAM; 14), Security and Risk (12), Customer Workflows (18), Employee Workflows (10), and Creative Workflows (18).

ServiceNow's status as the platform of choice to orchestrate the customer's technology chain is also demonstrated in its steady gain in customers with an annual contract value exceeding US$1 million.

The slide below is significant, especially if you consider the cost-cutting environment today.



Source: 1Q'23 earnings presentation

At the Smart All Stars Portfolio, we have made no secret of how pleased we are with the performance of ServiceNow's business, adding to our position twice in June 2022 HERE and November 2022 HERE.

We are comfortable with the company's strong FCF profile and net cash position of US$5.7 billion as of 31 March 2023.

If anything, ServiceNow may be a hop and a skip away from being elevated to Growth Titan status. For now, the business earns an easy Conviction Level 1 rating.

Growth Leaders: Conviction Level 1

Shopify (NYSE: SHOP)

Since making its debut in September 2020, Shopify's business has gone through a roller coaster ride.

That's putting it mildly.

To start, the eCommerce solutions site was a key beneficiary of the pandemic when its revenue almost tripled between 2019 and 2021.

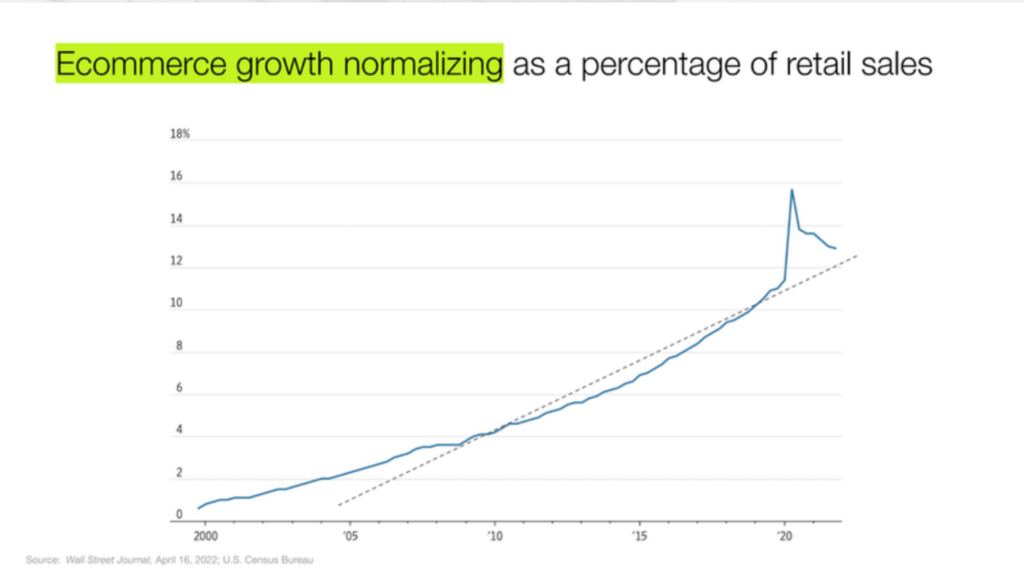
The first big announcement came in February 2022 when Shopify signalled its intent to invest heavily into its Shopify Fulfilment Network (SFN), which we covered in detail HERE:

1. For a sense of scale, 2022 to 2024's three-year capital expenditure (capex) would have been more than US$2 billion, over 40x its 2021 capex of US$50 million.

2. At the time, we put our trust in CEO Tobi Lütke's judgement, noting that he does not take major investment decisions lightly.

3. Shopify was also coming off a strong year where it generated US$454 million in FCF.

With the benefit of hindsight, eCommerce growth (as a percentage of retail sales) had started to normalise as pandemic-related restrictions were lifted.



Source: Shopify's 1Q'22 presentation slides

Despite the normalisation, Shopify did not back off:

1. The eCommerce firm made a bid for Deliverr in 1Q'22, an asset-light logistics platform for US$2.1 billion. We covered the details HERE.

2. SFN also launched a pilot program with Flexport to reduce freight forwarding lead time.

The move made sense for what Shopify wanted to achieve.

At the same time, we did not like its use of shares to finance 20% of its Deliverr purchase.

Speaking of finances, the SFN investment started to bite hard, sending Shopify's FCF into negative territory for the first three quarters of 2022.

In truth, the management team started to realise it had been overzealous in its predictions back in 2Q'22, as the passage by President Harley Finkelstein showed (bolded for emphasis):

> "So now, for some real talk.
>
> **Shopify has always been a company that makes the big strategic bets our merchants demand of us.**
>
> This is how we win.
>
> During the pandemic, we made a bet that retail spend would disproportionately favor e-commerce at a much higher pace than it has.
>
> **We couldn't know for sure at the time, but we did know that if the prediction came true, we would have to rapidly scale the company to meet that future.**
>
> Fast forward to now, as things have turned out differently."

As a result, the Canadian company made the difficult decision to trim 10% of its employee base as it buckled down for a tougher retail environment.

Meanwhile, SFN continued to gain traction with 75% of September 2022 domestic packages delivered within two business days.

But alas, it was not to be.

In May 2023, Shopify made the surprising move to sell the majority of its logistics business, including Deliverr, to Flexport in exchange for a 13% stake in the latter. Shopify would also have a seat on Flexport's board.

At the same time, the Canadian firm also decided to part ways with 6 River Systems (6RS), a warehouse automation firm Shopify acquired in 2019 for US$450 million.

The swift decision caught us off guard:

1. Deliverr's sale came less than a year after Shopify acquired the logistics platform.

2. It's hard to put a current value on Flexport which is privately owned. According to CNBC, the logistics firm was valued at US$8 billion in February 2022 based on its Series E funding round.

3. If so, a 13% stake would be worth a little over US$1 billion, representing a significant loss on Shopify's part.

4. We do not have figures for the sale of 6RS.

As a result, Shopify expects to take an impairment of US$1 billion to US$1.5 billion in the aggregate for the sale of various parts of its logistics business.

In addition, the Canadian firm has decided to further reduce its workforce by another 20%, in conjunction with the sale of its logistics business.

Needless to say, the series of missteps has left a big black eye on CEO Tobi Lütke and his crew.

We can't say we are pleased with the way things have played out.

Yet, we still think Shopify is a Conviction Level 1 stock.

As investors, we want to recognise the positives amid the negative outcomes. In particular, we think that Shopify has done a fantastic job in delivering eCommerce innovation:

SFN: Let's start with the elephant in the room.

Shopify did offer a decent argument for why it decided to part ways with its logistics business. In simple terms, after working with Flexport, the Canadian firm found that Flexport was far more focused on logistics, and would become a great partner.

In essence, while the move is painful, Shopify felt that it would be able to accelerate SFN adoption if it handed over the reins to Flexport.

Finklestein pointed out that Shopify has a track record of successful partnerships, joining hands with Stripe for payments and **Affirm** (NASDAQ: AFRM) for its buy now, pay later (BNPL) initiative.

Note: In June 2021, Shopify reportedly confirmed that it had a US$350 million stake in Stripe.

Flexport would become a preferred but not an exclusive partner.

There are, of course, downsides to partnerships where the balance of power may shift or partners could turn into competitors. We covered this risk in our September 2020 case study HERE.

Shopify Audiences: In 1Q'22, we remarked how well CEO Tobi Lütke took direct feedback from a merchant on Twitter and launched Shopify Audiences three months later.

It's not a Kumbaya story, mind you.

A year later, in 1Q'23, Shopify Audiences has been identified as the key reason why merchants upgrade to a Shopify Plus subscription.

With 10% of US eCommerce flowing through Shopify, Finkelstein said the company was in a unique position of having the requisite scale and merchant's trust to pull off such a solution.

The mention of scale also hints at Shopify's future ambition to leverage its data.

Commerce Components by Shopify (CCS): In simple terms, CCS is a Lego-like solution aimed at large enterprises that can now choose the Shopify components they want and integrate them with their existing solutions.

This flexible solution is particularly useful for opening conversations with large businesses which was previously not possible.

Meanwhile, Shopify has signed agreements with global system integrators such as IBM Consulting and Cognizant (NASDAQ: CTSH), adding to its previous deals with Accenture (NYSE: ACN), Deloitte, Ernst and Young, and KPMG.

Shopify Markets: Shopify Markets is motivated by a simple purpose: to help merchants sell internationally. In 3Q'22, Shopify reported that over 175,000 merchants had signed up to offer a localised experience for overseas buyers.

Shop App: Similar to Shopify Markets, Shop App was designed to help merchants attract more buyers.

In particular, Shop App enables merchants with limited resources to launch a mobile sales channel and build a direct relationship with their customers.

Since being launched in 2020, the mobile solution is being used by "10s of millions" every month. In 2022, Shopify enabled about US$28 billion in cross-border sales with 28% of all traffic coming from outside the merchant's country.

Shop Pay: Shop Pay, powered by Stripe, complements the Shop App experience.

In a post-cookie world, as Shopify puts it, there are "well over 100 million buyers" who have opted for Shop Pay, an accelerated checkout which handled US$11 billion in gross merchandise volume in the 4Q'22 and a cumulative US$77 billion since its introduction in 2017.

Shop Pay also unlocks the ability for Shopify to offer BNPL.

In summary, if we take a step back and look at the big picture, here are our latest thoughts:

1. We suspect that Shopify will be looking to leverage its first-party data trove to drive more services. As artificial intelligence (AI) takes hold, the eCommerce platform could hold a significant advantage at the start.

2. As we noted back in 1Q'22 HERE, normalising eCommerce growth does not mean stagnation. Growth will return to its previous trajectory, which was upward.

3. We have decided to keep Shopify in the Leader segment in large part due to its reliance on partners for key parts of its business, primarily payments and logistics.

Growth Leaders: Conviction Level 1

Tractor Supply (NASDAQ: TSCO)

There are a good number of companies that benefited from the pandemic. But there aren't as many from this cohort that managed to build on what they gained over the past three years.

Tractor Supply was an unlikely beneficiary when COVID-19 swept through the globe. Early on, in October 2020, the rural lifestyle company took decisive action, capitalising on its popularity to further expand its business.

We covered all the details in our exclusive November 2020 deep-dive HERE:

1. Tractor Supply estimated that its total addressable market (TAM) was nearly US$110 billion, where the company only had a 10% market share back then.

2. The rural lifestyle company went on a store renewal drive, targeting stores which are 15 years or older to be refreshed under Project Fusion.

3. With curbside delivery catching on, Tractor Supply tapped into the trend to build new side lots at its existing stores, creating large gardening centres.

Above all, the company stuck to its roots, focusing on its simple but effective GURA customer service (greet, uncover, recommend, and ask). Tellingly, almost three-quarters of customer comments were positive.

As we highlighted in our July 2020 case study HERE, Tractor Supply's service staff are unique, with each store hiring a welder, a rancher, a farmer and an equestrian to assist customers.

Speaking of customers, the firm's Neighbor's Club loyalty program has grown to over 30 million strong, twice the number prior to the pandemic.

As we highlighted in February 2023's Top Favourite Stocks HERE, members accounted for 75% of its overall revenue for FY22 and a solid 50% in its Petsense stores, demonstrating its halo effect on all product categories.

Other noteworthy developments include:

1..In 1Q'FY23, Tractor Supply reported that mobile app sales account for one out of every five digital revenue dollars made.

2. The integration of Orscheln stores, which is an acquisition we covered HERE, is ahead of schedule and was a significant contributor to its 1Q'FY23 topline growth.

3. In its latest quarter, Tractor Supply also provided another glimpse of its product mix, with two segments, namely companion animal, and livestock and equine taking up almost 40% of overall revenue.

4. Interestingly, three out of every four Tractor Supply customers own a pet and half of them have more than one; both stats bode well for its companion animal category.

5. For the latter, the rural lifestyle firm is confident that it is the market leader with a 20% market share for animal feed..

6. In our July 2022 exclusive deep dive HERE, Tractor Supply raised its TAM to US$180 billion, with Project Fusion and Side Lot opening up US$40 billion in new opportunities.

7. The company also raised its target store count to 2,700.

Amid the expansion, the key element which was missing was a healthy increase in FCF due to the heavy capital investments the company undertook.

That changed in February 2023.

Tractor Supply said that capital expenditure has peaked and will start to moderate in FY23 and beyond. In particular, 80% of its expected capex spend in FY23 is for growth initiatives.

We will have to wait for a few more quarters for signs of improved FCF.

In the meantime, we don't see anything that would prevent Tractor Supply from being a Conviction Level 1 stock.

Growth Leaders: Conviction Level 2

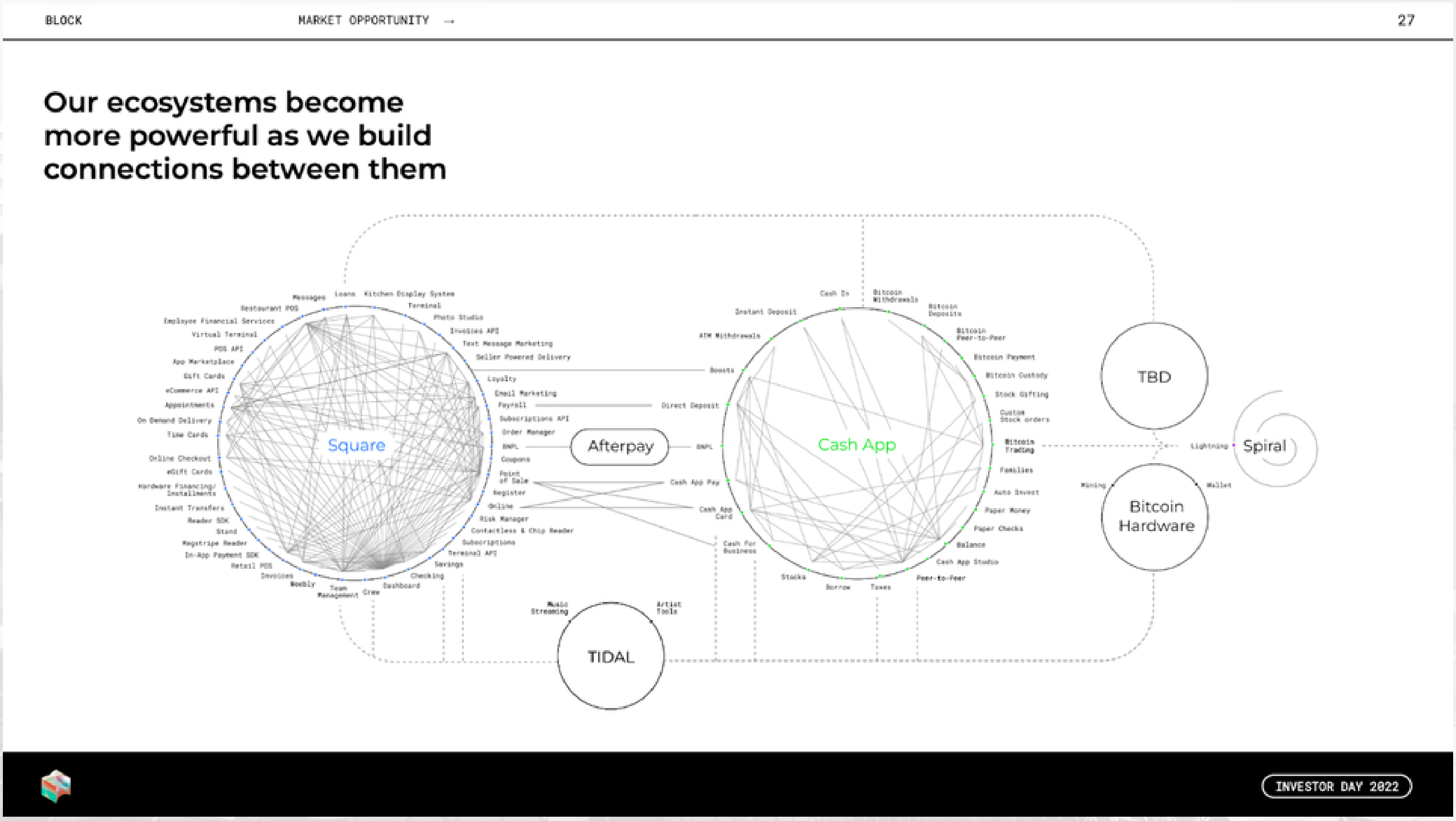
Block (NYSE: SQ)

As a business, Block is an acquired taste.

There are parts of its business that delight an investor's taste buds. And yet, there are other parts which leave you scratching your head.

On one hand, the firm has created an ecosystem of ecosystems, anchored by a valuable two-sided network of Square and Cash App.

Yet, on the other hand, the company's investment into areas such as TBD, a open protocol creator, and TIDAL, a global music and entertainment platform, leave us wondering if the company of its size should be attempting so many initiatives.



Source: Shopify's 1Q'22 presentation slides

The two main ecosystems, without a doubt, are Cash App and Square.

Cash App: In March 2023, Cash App monthly transacting actives hit a new high of 53 million.

New functions such as direct deposit and savings accounts have quickly caught on, attracting two million and three million actives, respectively. These two examples demonstrate the halo effect the company is able to generate.

That's the positive side.

On the flip side, Cash App Card, which is essentially a **Visa** (NYSE: V) debit card, is responsible for 38% of March's overall actives and underpins overall inflows into Block's Cash App.

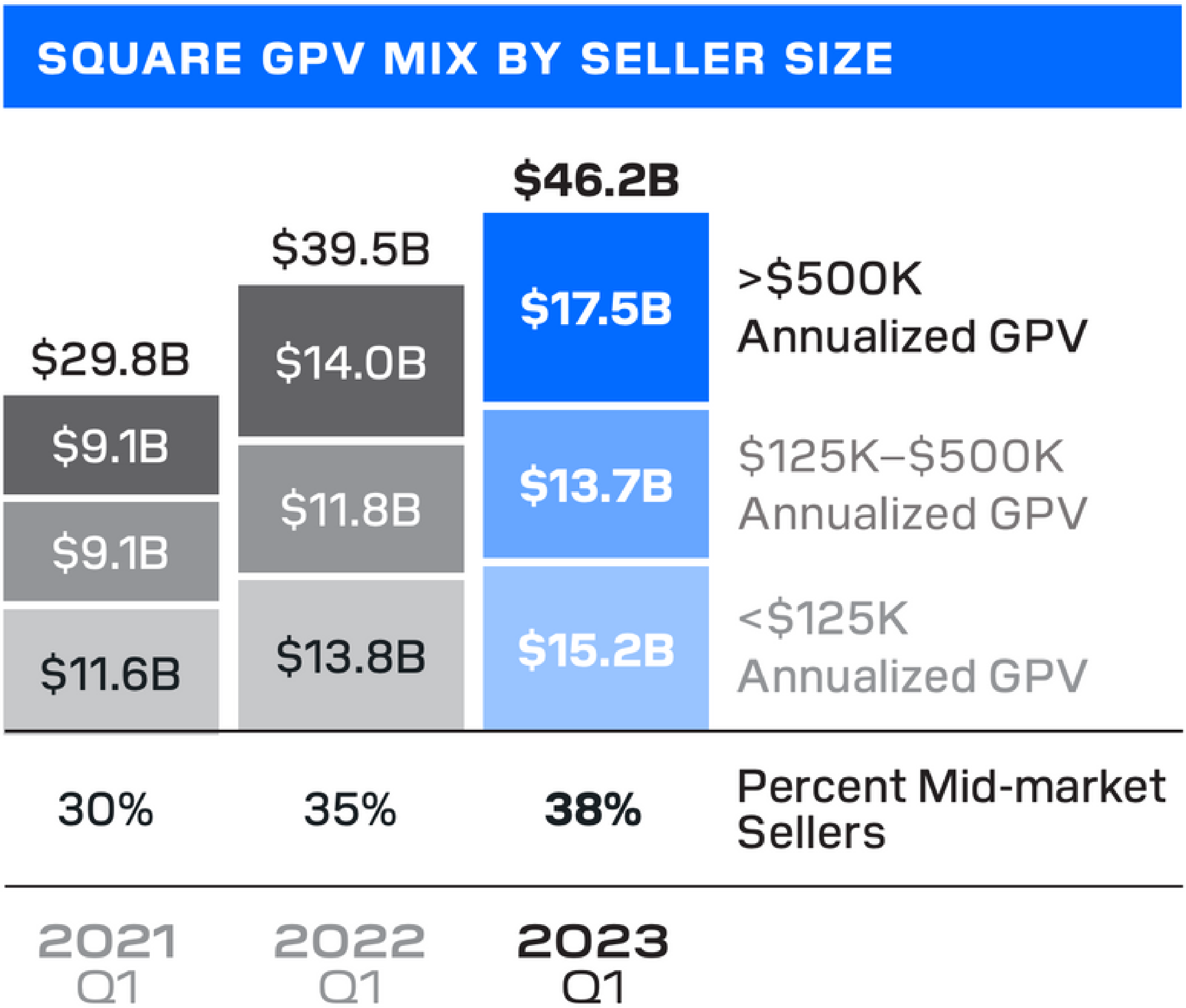
Cash App Card is also responsible for more than US$750 million of Cash App's gross profit for 2022 or over a quarter of the segment's gross profits. Such a statistic opens the door for critics to claim that it is reliant on Visa.

It's fair to question Block's monetisation strategy for Cash App.

Square: Square, of course, is the big brother and far more mature as a business.

On one hand, Square continues to gain in gross payment volume (GPV), chalking up US$46.2 billion in 2023's first quarter (1Q'23). More importantly, the company continues to make inroads into the mid-market segment which contributed a GPV of US$17.5 billion, or 38% of the quarter's GPV.

As we shared in our exclusive deep-dive HERE, the mid-market segment is Square's largest opportunity, representing a potential of US$4 trillion in US gross receipts.



We determine seller size based on annualized GPV during the applicable quarter. A mid-market seller generates more than $500,000 in annualized GPV. GPV does not include transactions from our BNPL platform because GPV is related only to transaction-based revenue and not to subscription and services-based revenue. Gross profit from mid-market sellers does not include gross profit contributions from our BNPL platform.

Source: Block's 1Q'23 Shareholders' Letter

On the other hand, Block's decision to acquire AfterPay for a pretty penny has come under fire.

For instance, we could point out that **PayPal** (NASDAQ: PYPL) has recently reported that its BNPL service had over 32 million consumers and almost three million merchants, making it the most popular BNPL option in the world.
For completeness, Block's AfterPay purchase was criticised by prominent short-seller Hindenburg, which we covered HERE. Hint: we thought their claim was pretty rich.

To round it up, there is the question of finances.

Again, we can applaud and criticise Block equally on this matter.

On one hand, the fintech has listened to investor feedback and voluntarily adopted a new measure: adjusted operating income.

This measure takes into account the impact of stock-based compensation.

In our April 2023 update, we applauded the move as it was not a metric chosen to make itself look good. Instead, Block embraced the measure as a way to keep itself accountable.

On the other hand, Block only managed to bring in a minuscule amount of FCF for 2022, a far cry from the US$713.5 million it generated in 2021.

We do see positive signs in 1Q'23 where Block brought in US$215 million in FCF.
As you may have gathered by now, there are one too many uncertainties which do not make Block our first choice in terms of positions to add.

Hence, Block has been filed as a Conviction Level 2 stock.

Growth Leaders: Conviction Level 2

Netflix (NASDAQ: NFLX)

If you have followed Netflix since its debut in the Smart All Stars Portfolio in October 2020, you may feel like you have been through hell and back.

Here's the good news: going through such a sharp dip gives you a full-on appreciation of how great companies are hard to keep down. It's a learning experience that you can apply throughout the rest of your investing journey.

In fact, I (Chin here) decided to document the ups and downs (or should I say downs and ups) in a Business Times article which we have reposted on our site HERE.

Here's what played out ...

Netflix was a beneficiary of the pandemic. That is, until it hit a wall in the 2022 first quarter (1Q'22). The online streaming firm found itself losing 200,000 subscribers while forecasting a further loss of two million in the following quarter.

At the first sign of trouble, as we explained in our January 2023 monthly update HERE, much of the time is spent on explaining what happened.

The commentary is often candid, and necessary to understand the situation.
But doing so also makes Netflix an easy target for critics.

That is the price to pay.

As expected, the financial media had a field day, slamming the management for its incompetence, while pointing towards the obvious horde of competitors stealing market share.

Amid the deafening noise of the naysayers, here's what we said in April 2022:

"... there's one thing that has worked for us in the past:

If we are going to err on one side of this decision, we will err on the side of the leaders that have come to define an industry.

That is why we have chosen to back Reed Hastings."

Mind you, ours is not a conviction built on sand. It's a conviction solidified having watched how Hasting has responded to adversity over the past 15 years. Signs of progress needed time to show themselves.

In the time in between, most investors gave up, sending the stock towards a five-year low.

But not the Smart All Stars Portfolio.

While we didn't give up on Netflix, we certainly did not expect good news to arrive so soon. Our November 2022 update HERE and January 2023 update HERE were the some of most satisfying posts to write:

1. In 3Q'22, Netflix posted an increase of 2.4 million subscribers, before closing 2022 with a massive gain of 7.7 million subscribers in 4Q'22. The sequential gain of more than 10 million subscribers in six months put to rest the unfounded concerns that the online streaming firm was dying.

2. Instead of competitors snatching market share, reality caught up with Netflix's major competitors who started increasing their subscription prices while pulling back on content spend. The telling stat: competitors recorded an estimated US$10 billion in operating losses in 2022.

3. As everyone pulled back, Netflix launched a lower-priced basic-with-ads option, opening up the possibility of a higher-margin business to add to its huge recurring base of existing subscribers.

In short, the tables have truly turned in favour of Netflix.

As we step back and look at the big picture, we have even more evidence now that our original assertion HERE, rings true:

"To be able to sustain the Netflix ecosystem, scale is needed. That explains why Netflix has been aggressive in its race to become the largest online streaming service in the world.

By having the biggest subscriber base, the cost of content can be spread out, enabling Netflix to afford more content, and in turn, make its service more valuable to customers compared to other competing services."

That is vindication.

As it stands, the only thing lacking is signs of traction for Netflix's basic with ads initiative, along with the company's push for subscribers who use shared passwords to pay their fair share.

For that reason, we are putting the online streaming company as Conviction Level 2.

This move is consistent with our decision to move Netflix from Growth Titan to Growth Leader in April 2022 HERE, in recognition of the crowded playing field.

Growth Leaders: Conviction Level 3

DocuSign (NASDAQ: DOCU)

When the pandemic struck, eSignatures became an instant need.

Buoyed by overwhelming demand, DocuSign focused on capturing as much customer demand as it could handle.

We can't fault the company for doing so; it was the right move to make at the time. But as time has revealed, DocuSign's lack of focus in cross-selling non-eSignature solutions would come to haunt the company later on.

Things came to a head in the fourth quarter of the financial year ending 31 January 2022 (4Q'FY22).

Then-CEO Dan Springer was candid in admitting that the sharp shift in customer buying behaviour caught the company off guard. In response, DocuSign had to rapidly retool its sales team:

"We saw a **diminished level of urgency in their buying patterns**.

Customers turned their focus to investments and projects that were delayed during the heart of the pandemic.

As we saw urgent demand wane, **we had just begun to shift in our sales motion back to a demand generation mode of cross-sell, up-sell and departmental expansion**.

While we excelled at demand generation for many years pre-COVID, ultimately, **the shift in customer buying patterns coming out of the pandemic was quicker than we anticipated and we didn't move fast enough as an organization.**"

In doing so, Springer identified a critical flaw: the company lacked the right executives to manage the business at its post-pandemic scale.

For a sense of this massive change, DocuSign's revenue nearly tripled between FY19 and FY22, growing from around US$700 million to US$2.1 billion in FY22. Today, the eSignature company's topline for the past 12 months is close to US$2.6 billion.

Then, in 1Q'FY23, Springer announced a slew of executive changes, essentially swapping out almost all its executives, from product development to worldwide sales and human resources.

We covered the changes in our exclusive deep dive HERE.

This drastic move proved to be Springer's final act as CEO.

Maggie Wildtrotter, Chairman of DocuSign's board of directors, took over as interim CEO before announcing the appointment of Allan Thygesen, a Google veteran with a promising product and business pedigree.

Amid the uncertainty, the business environment got tougher with customers scrutinising every dollar spent.

Thygesen had his work cut out.

To his credit, he wasted no time in signalling changes in the company's focus, going forward:

1. Unlike Springer's sales-centric approach, Thygesen had a clear interest in boosting product development. In fact, he made a point that DocuSign had under-invested in research and development (R&D) compared to its SaaS peers.

2. The focus on the product is no accident. As we alluded to earlier, Thygesen is keen to emulate Atlassian's product-first approach where customers are able to self-serve at every stage of the order cycle.

3. Finally, with a larger suite of products, Thygesen will be focusing on bundling the right mix of solutions for optimal pricing and growth.

Speaking of product innovation, we are pleased with what he has delivered so far.

In 1Q'FY24, Thygesen shared three new product releases:

1..Webforms, which was released in April, is seeing strong traction across document-intensive verticals such as financial services, real estate, healthcare and life sciences.

2. Speaking of industries, DocuSign's eSignature is also making inroads into regulated markets. For example, it is now connected with electronic health record (EHR) providers Epic and Cerner (NASDAQ: CERN).

3. DocuSign has also introduced ID verification for a European Union (EU) qualified eSignature.

Moving to partnerships, Thygesen has managed to get DocuSign in the front line to showcase its products during Microsoft's (NASDAQ: MSFT) Azure OpenAI event.

At the same time, DocuSign has also joined SAP's (NASDAQ: SAP) Endorsed Apps program.

Source: DocuSign's 1Q'FY24 presentation slide

Finally, when it comes to financials, DocuSign remains as strong as ever.

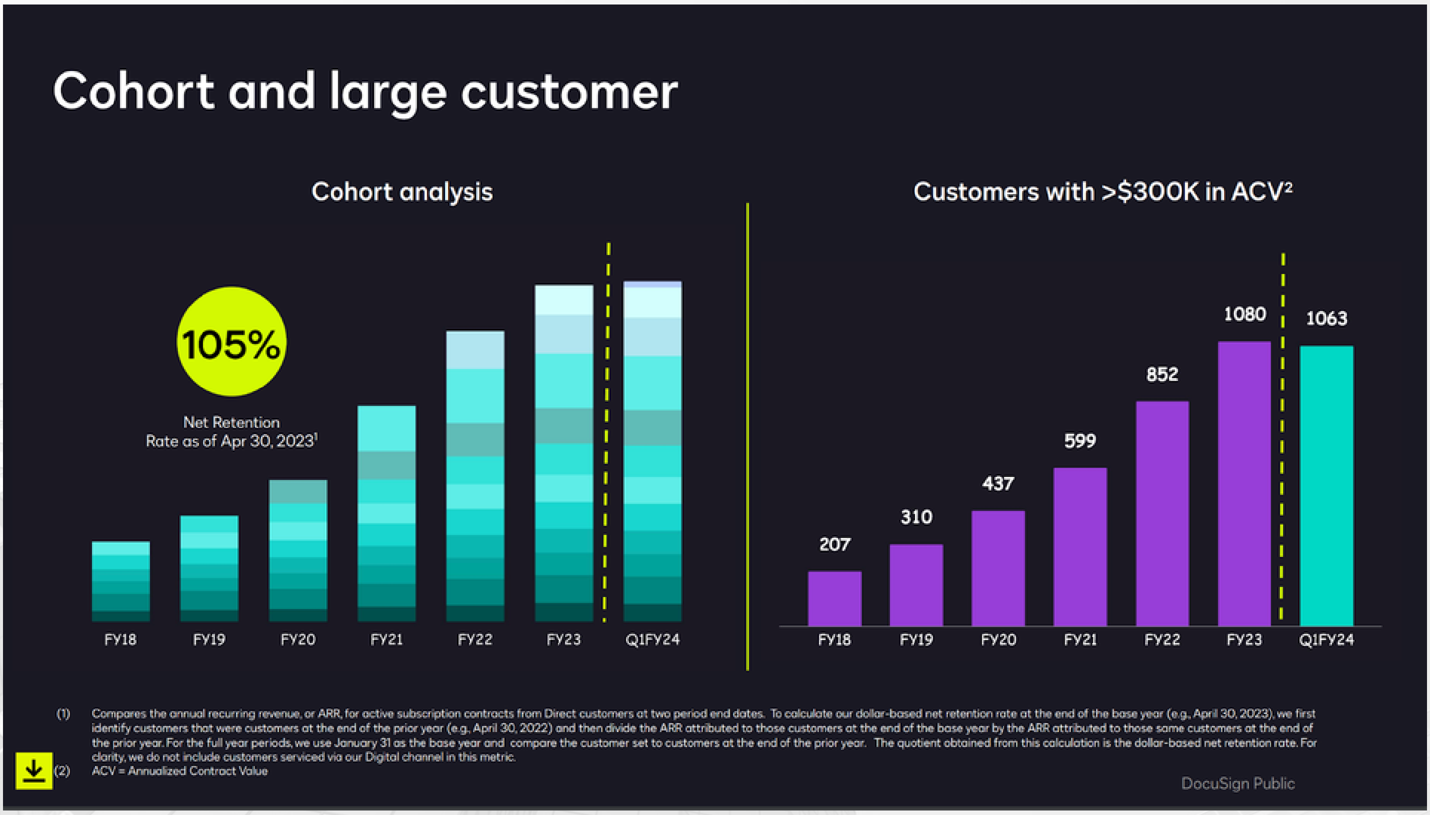
1. For 1Q'FY24, the eSignature firm generated US$215 million in FCF, up 23% from a year ago.

2. As of 30 April 2023, DocuSign's balance sheet was fortified with US$1.4 billion in cash, cash equivalents, and investments along with US$724 million in debt in the form of convertible senior bonds.

In short, it is hard to be displeased with Thygesen's progress so far.

So, what's holding us back?

In a single slide, this is the potential problem we see.



Source: DocuSign's 1Q'FY24 presentation slide

We are seeing cracks in DocuSign's business.

In 1Q'FY24, DocuSign only managed to record a 105% net retention rate and further expects this ratio to decline again in 2Q'FY24. Worryingly, customers with annual contract values of US$300,000 or more shrank from 1080 in 4Q'FY23 to 1063 in 1Q'FY24.

For its part, DocuSign said that the decline was down to lower expansion rates (read: customers buying less) and partial churn.

In essence, a risk we identified in our November 2020 case study HERE, the second act, is the key question here.

Thygesen has defined his product-led strategy but it needs time to bear fruit.

At the same, we cannot shy away from the deterioration of these key business metrics; it is simply the harsh reality the company faces.

Will the business get worse before it recovers?

When will Thygesen's increased focus on product innovation bring results?

Can Thygesen pull off a strategic change in the business?

Will Thygesen get the time he needs to engineer a change which could be good for the long term?

As you can tell, there are more questions than answers.

That is why we think it's prudent to park DocuSign in the Penalty Box or Conviction Level 3 rating. If the business continues to deteriorate, we may be forced to part ways with the company.

Growth Leaders: Conviction Level 3

Illumina (NASDAQ: ILMN)

We're not going to lie.

The decision on whether to put Illumina as a Conviction Level 3 was the toughest deliberation we had to make among the Leader cohort. Recent events, which we will explain below, pushed us to make the move.

Much of what you need to get caught up with the stock can be found in our detailed March 2023 updates HERE and HERE.

Here's the gist, along with updated details from Illumina's 2023 first quarter (1Q'FY23) earnings:

1. Revenue was down for its last two quarters, but for a good reason; Illumina is ramping up for a major transition to its new high-throughput system, NovaSeq X.

2. In 4Q'FY22, Illumina said it had 155 NovaSeq X instruments on pre-order and over 250 in its advanced pipeline. The total amount (over 405) outstrips the number of 2022 shipments (340) for its predecessor, NovaSeq 6000. In 1Q'FY23, the number of orders increased to over 200 from over 30 countries.

3. Illumina has made end-to-end preparations to deliver 330 NovaSeq X systems in 2023, guiding for a revenue increase of between 7% and 10% year on year for FY2023.

In our update in March 2023 HERE, we went into deep detail on why the NovaSeq transition is so critical to Illumina.

We also delved into the long-awaited projection for GRAIL revenue ("as much as US$1.36 billion" by FY2028) along with the ramp-up plan for its Complete Long Read instrument which will be available starting with arrays in the first half of 2023.

In summary, everything we hoped for in Illumina, barring GRAIL's legal wranglings, was progressing as we expected in our January 2021 case study HERE.

Then, Carl Icahn came along and upset the apple cart.

In our update HERE, we have made our distaste for Icahn's methods clear.

The activist investor is known for forcing businesses into short-term-minded moves such as conducting massive buybacks, merging with other companies, or pushing for the business to be acquired. All for a short-term pop in the stock.

Ironically, another short-seller, Hindenburg Research, has even called out Icahn Enterprises (NASDAQ: IEP) as a "Corporate Raider Throwing Stones from his Own Glass House", causing IEP share prices to tank.

At this point, it is important to be clear: we won't normally react strongly to short sellers such as Icahn, mainly because we believe the strength of the business will survive his shenanigans.

This time, however, it could be different as Icahn is under pressure to perform
.
As it turns out, two key things happened in Icahn's proxy battle:

1. Icahn's representative, portfolio manager Andrew Teno, won a seat on Illumina's board of directors, ousting Chairman John Thompson.

2. CEO Francis de Souza, who we consider to be a leader of rare pedigree, has resigned despite surviving the proxy battle. For a company in a nascent industry, we think his departure is a major blow.

So, where does it leave investors?

Much will depend on what happens next. We still think the business is fine but we are unable to predict what Icahn may push for under duress.

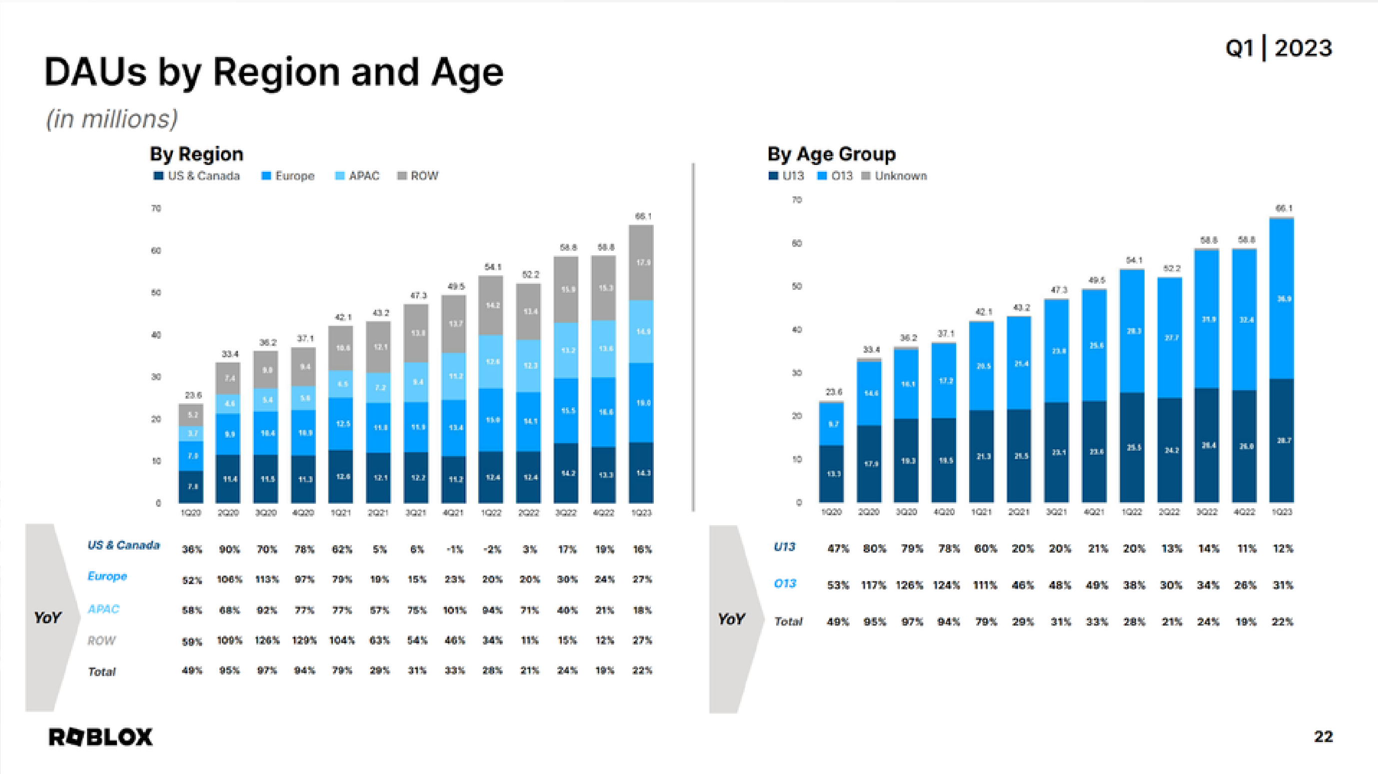
Hence, we are taking a cautious approach due to the uncertainty — Illumina will be a Conviction Level 3 stock.

Growth Leaders: Conviction Level 3

Roblox (NYSE: RBLX)

Roblox made its debut in the Smart All Stars Portfolio in December 2021.

The pandemic, by and large, has been a boon for Roblox, helping it almost triple its daily active user (DAU) base, as shown in the slide below.



Source: Roblox's 1Q'23 earnings presentation

More importantly, Roblox has been able to keep AND grow its user base even after COVID-19-related movement restrictions were lifted.

To be sure, the ride wasn't always smooth.

While Roblox's user base grew, the increase did not always translate into higher bookings, a matter of concern which we highlighted in our exclusive updates HERE and HERE.

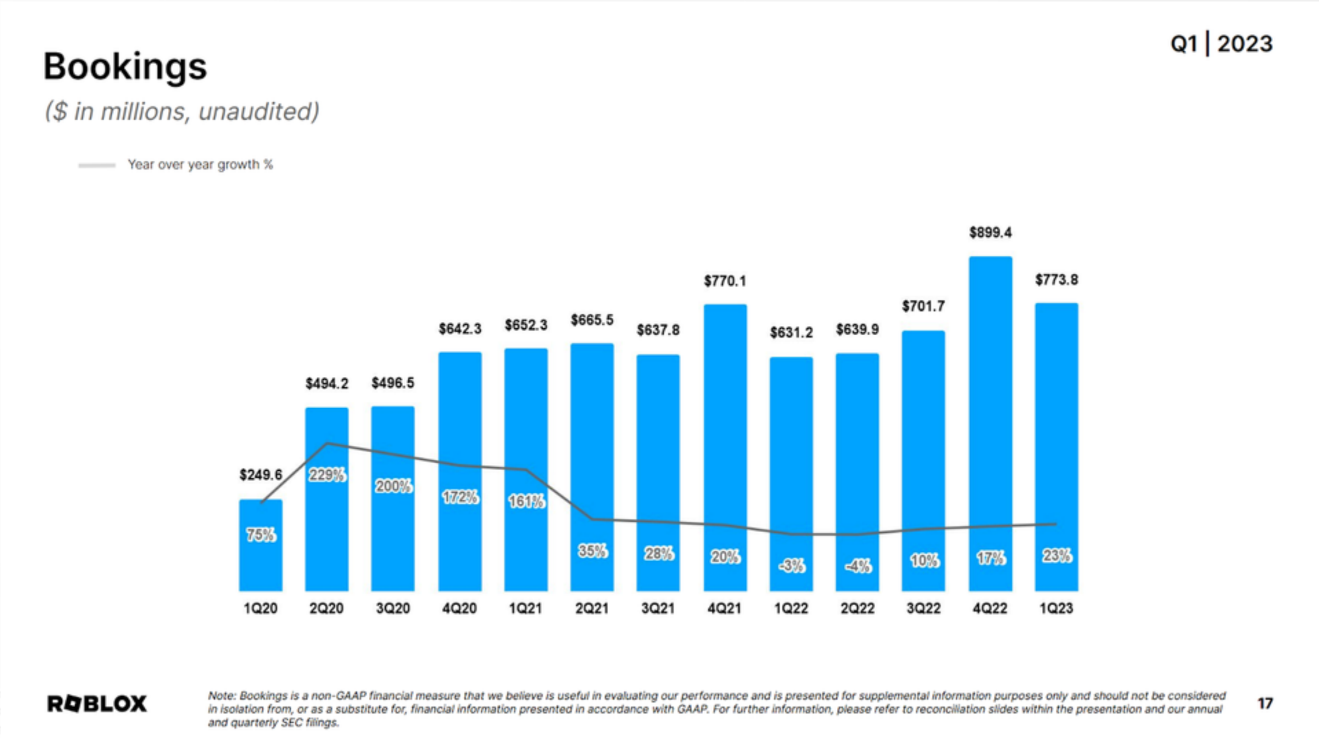
Explanatory note: We explained how Roblox recognises revenue in our case study HERE and in our previous update HERE.

<u>As a reminder</u>:

1. Quarterly Robux purchases are captured as bookings.

2. The current revenue growth is (mostly) the collective result of previous Robux purchases.

3. Bookings provide a hint of how the company did during the quarter.



Source: Roblox's 1Q'23 earnings presentation

While bookings lagged behind the growth in user engagement, Roblox did make the situation uncomfortable by ramping up its investments across the board including developer exchange fees, new personnel hires, and capital expenditure.

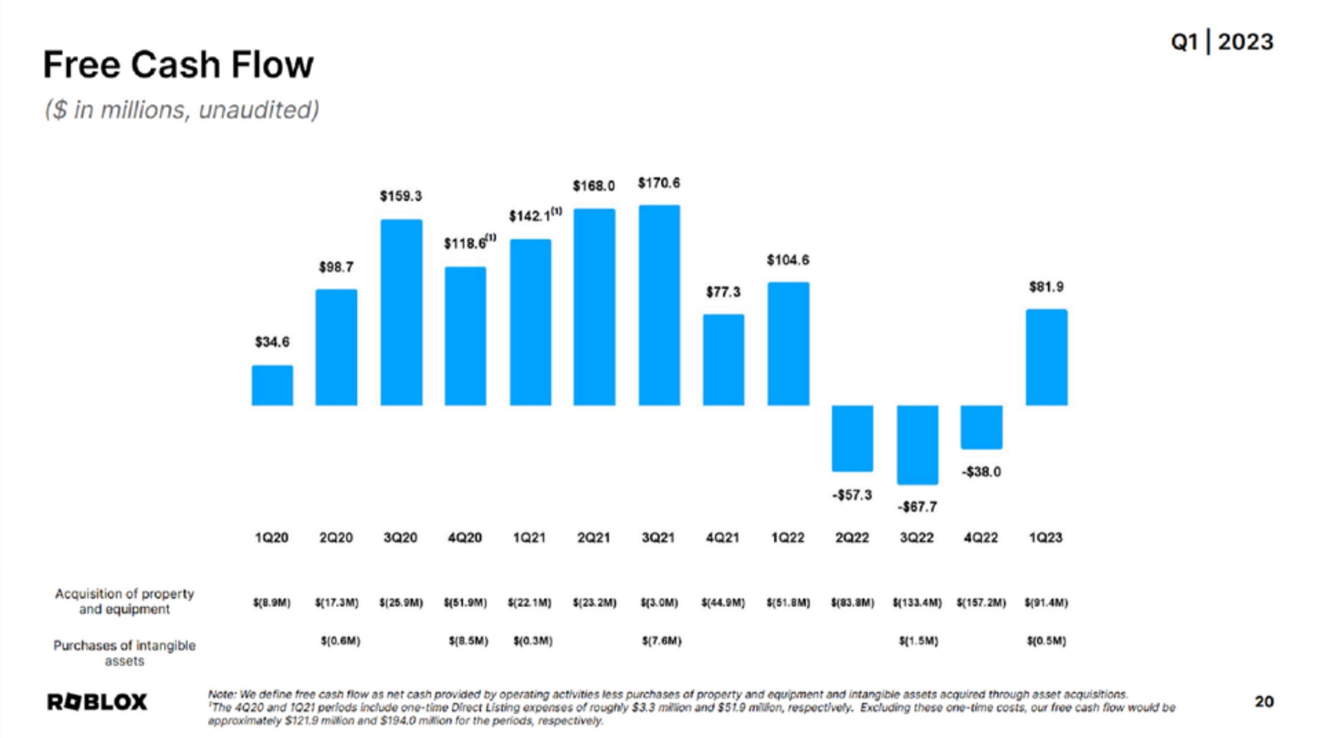
We shared our thoughts in our deep-dive updates <u>HERE</u> and <u>HERE</u>:

1. The percentage payout from bookings to developers has steadily increased from an average of 17.5% in 2020 to 19.5% in 2021 and a little over 22% for 2022's 9M'22.

2. As the platform operator, Roblox will have to strike a fine balance etween making its platform enticing enough for developers to create experiences while being able to earn its fair share of the cash that is generated.

3. Roblox is building its own cloud, suggesting that it will continue its capital spending in the future as it aims to bring a billion DAUs to its platform.

The end result was undesirable with FCF turning negative for three quarters in a row, as shown in the slide below.



Source: Roblox's 1Q'23 earnings presentation

To be sure, there are reasons to be optimistic:

1. Roblox has signalled that it will be slowing down its hiring to allow time for the organisation to digest these new hires.

2. For 2023, the metaverse platform operator also plans to reduce capex by between 25% and 30%.

The commentary above implies that Roblox will go through bouts of heavy capital spending, punctuated by pauses to "catch its breath".

On that note, we are seeing some positive signs show up in 1Q'23:

1. Bookings rose by a healthy 23% year on year to US$773 million for 1Q'23.

2. More importantly, Roblox pointed out that this rate of increase exceeds its cost of sales growth in 1Q'23. Furthermore, the metaverse platform is projecting that its bookings growth will surpass its infrastructure spending growth rate by 3Q'22 and compensation growth rate by 1Q'24.

3. Along with the above, Roblox's 1Q'23 FCF turned positive again, albeit lower than a year ago.

4. To round it off, the company pointed out that its cash position has held steady for the past six quarters despite the higher spending.

Speaking of positives, there are another three key developments to watch:

1. On operational efficiency, Roblox has been using AI to automate reviews of 3D objects, audio and image which helps to reduce costs for its platform safety organisation.

2. Still on AI, Roblox has launched two generative accelerators. Firstly, creators will be able to create 3D objects using a few words. Secondly, code generation will help users script on the Roblox platform.

3. Finally, Roblox is also testing its new advertising system which has garnered over 200 developers. Currently, its ad system consists of a combination of traditional ads (think banner ads) and what it calls portal ads (think Roblox portals to engage customers). Ad revenue will start to trickle in from 2Q'23.

So, where does all of the above leave investors?

We think that Roblox has taken its first step in earning our trust:

1. The 1Q'23 results were crucial in demonstrating that its investments in the platform can bear fruit. The projection for bookings growth exceeding operating expenses by 1Q'24 is another show of confidence.

2. The two points above support the view that Roblox is able to spend responsibly.

3. On the other hand, this is the company's first step in a nascent trend that will need to continually prove itself over a longer period of time.

4. Much like DocuSign, we would like to see its second act (ads revenue) gain meaningful traction.

In sum, we are taking the prudent step of keeping Roblox as a Conviction Level 3 stock.

Growth Leaders: Conviction Level 3

Zoom (NASDAQ: ZM)

It's no secret that Zoom has been the poster child of the pandemic.

Rarely have we seen a company so fortunate to be at the right place at the right time. We imagine many companies would love to see their revenue soar by 7x since the pandemic.

That's what Zoom achieved.

For context, the video conferencing firm's topline rose from US$622 million at the end of the financial year ending 31 January 2020 (FY20) to over US$4.4 billion over the past 12 months.

Yet, as we have seen in the case of DocuSign, such outsized growth brings new problems.

In essence, growing from a larger base is much tougher — hence, Zoom needs a second act, a risk we also highlighted as part of our August 2020 case study HERE.

It's not for want of trying.

In July 2021, Zoom attempted to acquire Five9, a cloud-based contact centre specialist, for US$14.7 billion. Two months later, however, both parties abandoned the deal when the latter failed to obtain shareholder approval.

Then, during its 2021 Zoomtopia event, Zoom revealed that Zoom Phone and Zoom Room adoption among existing customers (with more than 10 employees) had reached around 4% and 5%, respectively.

Zoom Phone, in particular, reached a 10% revenue contribution in the first quarter of the fiscal year ending 31 January 2024 (1Q'F24).

There are also new initiatives in the works:

1. The most promising solutions are ZoomIQ and Zoom Contact Centre. However, we shouldn't expect any meaningful traction (read: 10% revenue contribution) for another two years or more.

2. For ZoomIQ, Zoom has its own AI models, and is partnering with both OpenAI and Anthropic. Through these partnerships, Zoom is able to introduce new features such as Anthropic's AI assistant, Claude, to all its solutions.

3. Contact Centre contracts are also harder to land. Zoom is in the process of building up its sales team so we may want to temper our expectations.

4. In April 2023, Zoom announced the acquisition of Workvivo, an employee experience platform. No financial terms were disclosed.
al terms were disclosed.

Furthermore, we would be remiss if we didn't mention that Zoom is still financially strong.

In 1Q'FY24, the video conferencing firm generated close to US$400 million in FCF while boasting a clean balance sheet with almost US$5.6 billion in cash, cash equivalents, and investments.

In short, the firm has the financial firepower to invest where needed.

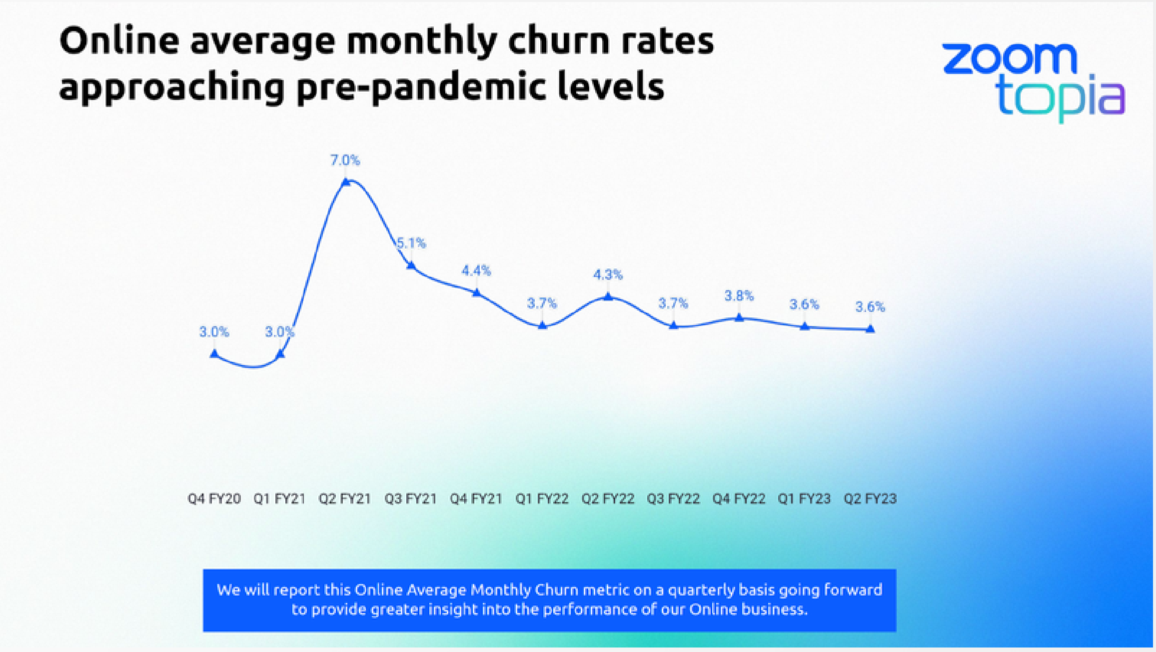
These are the positives.

Unfortunately, as it stands, visibility is low for Zoom's future revenue growth and FCF generation for a few reasons.

1. Online segment churn: Zoom enjoyed a boom in online sign-ups during the pandemic.

However, as countries lifted movement restrictions, churn rose sharply, as shown in the slide below. In 1Q'FY24, churn has fallen to 3.1%, and revenue from this segment is expected to stabilise.

A return to growth, though, is not expected for FY24.



Source: Zoomtopia 2022 presentation

2. Slowing enterprise growth: When it comes to revenue, enterprise growth has been the one positive trend which kept our hopes up. However, 1Q'FY24 growth has slowed to 13% year on year and is expected to further decline in the near term.

Zoom expects to see growth re-accelerate in 2H'FY24.

3. Higher R&D spending: Creating a second act is not free. As topline growth grinds to a halt, Zoom has to increase its spending in R&D while looking to cut back in other areas.

The impact is being felt at the FCF level which has fallen from its pandemic highs.

When it comes to valuation, we do not have visibility on a reliable FCF margin to use as operating margins are expected to decline in the interim.

In sum, the lack of clarity for a return to growth moves us to classify Zoom as a Conviction Level 3 stock until it can prove its new revenue streams can contribute meaningfully to its topline.

The Smart All Star Portfolio's 2021 buys: Before we close, the portfolio wants to acknowledge that it added more money to Zoom in February 2021 and November 2021.

In hindsight, we may have moved too fast.

Time will tell if we will be proven wrong. A lot will depend on what Zoom is able to do in the coming years. As it stands, the portfolio does not plan to add further to its existing position.

July 2023

GROWTH TRAILBLAZERS

Fiverr
MongoDB
nCino
Okta
Coinbase
Sea Limited

Growth Trailblazers : Conviction Level 2

Fiverr (NYSE: FVRR)

Fiverr has not lived up to its promise since its debut in the Smart All Stars Portfolio back in March 2021.

In our eyes, the success of the business hinges on two key factors:

1. Fiverr's ability to keep growing its network of buyers and sellers.
2. Exploiting its network effect to drive platform activity higher, thereby earning more transaction fees and other service fees.

For the first part, the number of active buyers has stalled post-pandemic.

In 2021's second quarter (2Q'21), Fiverr recorded four million active buyers on its platform. Since then, this number has only grown to 4.3 million in 1Q'23, a far cry from its pandemic-fuelled boom where it added a million active buyers in 2020.

To its credit, the spend per buyer did rise from US$226 in 2Q'21 to US$262 in 1Q'23.

As growth slowed, Fiverr shot itself in the foot by repeatedly revising its 2022 revenue forecast downwards.

To be clear, we are no fans of the management forecast game, which we said HERE and HERE. Here's a chronology of Fiverr's forecasts made between 4Q'21 and 3Q'22:

1..4Q'21: US$373 to US$379 million

2. 1Q'22: US$345 to US$365 million

3. 2Q'22: US$332 to US$340 million

4. 3Q'22: US$334 to US$340 million.

For the record, Fiverr ended 2022 with US$337.4 million in sales.

In general, we think that the forecast game is a distraction to the real work of building a sustainable platform.

But if that is the case, why did the Smart All Stars Portfolio add to its position in January 2023?

Our reasoning outlined in December 2022 HERE still applies (with updated figures):

1. As far as financials go, Fiverr still has a net cash position with US$535.9 million in cash, cash equivalents and marketable securities, while holding US$453 million in debt (all in convertible notes).

2. The Israeli company has undergone a cost optimisation process since July 2022. We are starting to see the first sign of its efforts. In 1Q'23, Fiverr's free cash flow (FCF) almost doubled, boasting a 15% FCF margin, above what we expected.

3. Furthermore, with Fiverr's network of buyers and sellers still intact, we think it's a just matter of time until the buyers and sellers return.

Fiverr's not standing still either.

The freelance platform owner is determined to move upmarket, with Fiverr Business being its key initiative on this front.

Along these lines, Fiverr will be folding Stoke Talent (a November 2021 acquisition) into Fiverr Entreprise to smoothen the transition for existing customers to Stoke Talent's solutions.

Despite all these initiatives, we could still be wrong.

The rise of ChatGPT and its ilk has prompted analysts at Oppenheimer to suggest that 40% of Fiverr's freelancer categories could be at risk from generative artificial intelligence (GenAI).

It's an area to watch for sure, but we think that this analysis may have gone into the deep end.

Here's what CEO Micha Kaufman had to say:

"We haven't seen AI negatively impact our business.

On the contrary, the categories we open to address AI-related services are booming. The number of AI-related gigs has increased over tenfold and buyer searches for AI have soared over 1,000% compared to 6 months ago, indicating a strong demand and validating our efforts to stay ahead of the curve in this rapidly evolving technological landscape.

We are witnessing the increasing need for human skills to deploy and implement AI technologies, which we believe will enable greater productivity and improved quality of work when human talent is augmented by AI capabilities.

In the long run, we don't anticipate AI development to displace the need for human talent.

We believe AI won't replace our sellers; rather sellers using AI will outcompete those who don't."

Our July 2021 case study HERE can be boiled down to four highlights:

As it stands, we are siding with Kaufman's assessment over Oppenheimer's. With that, we are ranking Fiverr as a Conviction Level 2 stock.

Growth Trailblazers : Conviction Level 2

MongoDB (NASDAQ: MDB)

1. MongoDB's noSQL database has inherent advantages compared with traditional SQL databases.

2. The popularity of this new database system is demonstrated by the rapid growth of its client base which, in turn, brings in recurring revenue.

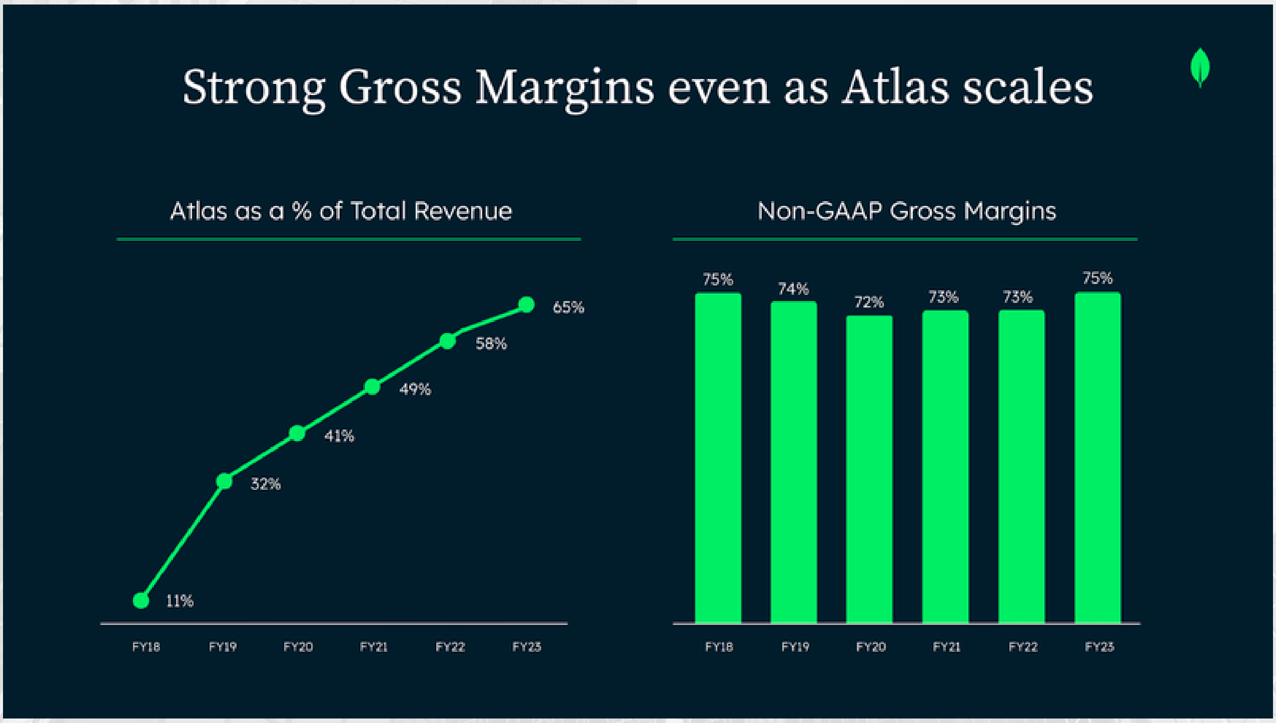
3. The New York company was starting to show signs of generating consistent free cash flow (FCF).

4. MongoDB Atlas was experiencing explosive adoption, and was fast becoming the main contributor for its revenue.

For the most part, MongoDB has delivered on its promise.

In our detailed update HERE, we have covered its progress in generating FCF (still work-in-progress) and its success in growing and diversifying its customer base.

Furthermore, MongoDB Atlas continues to gain ground, as shown in the slide below.



Source: MongoDB.local NYC 2023 update slides

MongoDB's ability to increase revenue during a tougher business environment has not gone unnoticed.

As CEO Dev Ittycheria shared during its first quarter of the financial year ending 31 January 2024 (1Q'FY24, bolded for emphasis):

"**We are pleased with our results this quarter, especially given the difficult macro environment**.

It's clear customers continue to scrutinize their technology investments and must decide which technologies are a must have versus merely a nice to have.

We believe that our Q1 performance and **continued new business strength demonstrate that MongoDB is clearly a must have for customers**.

In today's digital economy, most companies express their business strategy through software.

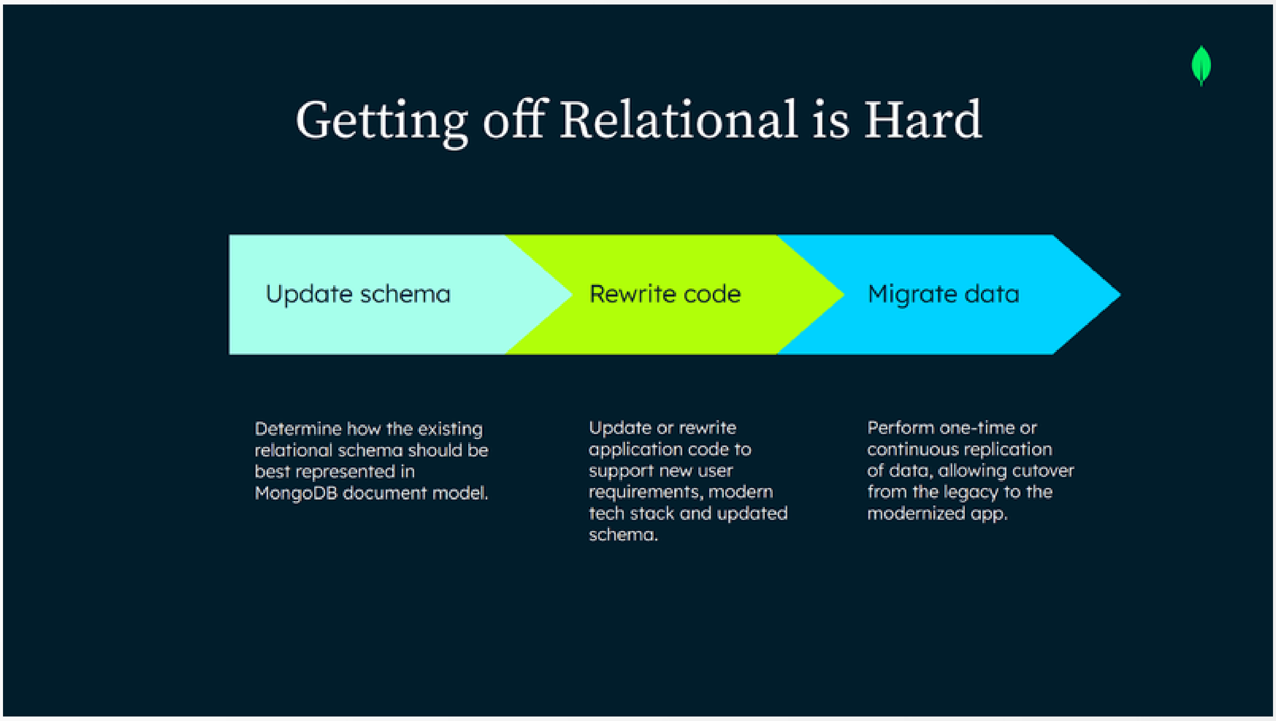
They use software to deliver their core value proposition, provide customers with great experiences and drive operational efficiency.

MongoDB is an essential platform and this drive for innovation, making us a critical investment priority."

So, if everything is on track, what are the doubts?

Let's start here: during its June 2023 event, MongoDB declared that it can fundamentally replace relational databases.

Yet, at the same time, the company has admitted that getting customers to migrate is no walk in the park, requiring a holistic approach involving technology, people, expertise and partnerships.



Source: MongoDB.local NYC 2023 update slides

Of course, the noSQL platform company is doing all it can to make this process easier.

In our member-exclusive update HERE, we have delved deeper into all its initiatives, ranging from creating a self-service Relational Migrator app to educating its customers and growing its partnership ecosystem to include global system integrators and jumpstart partners.

These efforts are necessary for MongoDB to achieve its full potential, in our view. After all, showing customers better technology is not enough to make them abandon traditional relational databases. Overcoming client inertia is a real challenge but essential if MongoDB wants to win over the mass majority.

Explainer: On this note, we highlighted in our Portfolio Spotlight (Cloud Computing) Lesson #7 HERE the concept of “Crossing the Chasm” where winning over the mass majority requires a different set of skills compared to the early adopters.

Using this framework, we suspect MongoDB may be making its move to take market share from the database incumbents.

Whether the company will be successful in crossing over remains to be seen.

For this reason, we are keeping MongoDB as a Conviction Level 2. We’re optimistic but will wait for the actual results to validate our investment thesis.

Growth Trailblazers : Conviction Level 2

nCino (NASDAQ: NCNO)

nCino started life in the Smart All Stars Portfolio on the front foot, confirming our June 2021 investment thesis by landing **Wells Fargo** (NYSE: WFC) as a customer in the second quarter of the fiscal year ended 31 January 2022 (2Q'FY22).

We covered the significance of this win HERE.

Referral sales are the key that unlocks vertical markets, therefore winning a contract from the US's third largest commercial bank was important for the company.

For more, check out Lesson #7 of our Portfolio Spotlight (Cloud Computing) HERE.

That said, things took a turn for the worse in the following quarter:

1. Firstly, the software-as-a-service (SaaS) company acquired SimpleNexus for a hefty US$1.2 billion. The move was surprising as it represented 22% of nCino's total market cap at the time.

2. At the same time, FCF for the 9M'FY22 turned negative.

Unfortunately, the news did not get better in FY23.

As the economic outlook dimmed, nCino switched into defence mode in late 2022, re-positioning itself into a "Rule-of-30" company where total revenue growth and non-GAAP operating income margin would approach 20% and 10%, respectively.

In hindsight, its move proved timely.

In March 2023, **Silicon Valley Bank** (SVB) collapsed from a bank run, setting off a chain reaction which led to Credit Suisse being acquired by its peer **UBS** (NYSE: UBS) last month.

Predictably, shares of nCino, being connected to the banking sector, took a beating.

So, where does it leave us today?

The good news is the initial shock over SVB's demise has dissipated and business is starting to return to normal. In 1Q'FY24, its latest quarter, CEO Pierre Naude said:

"... if you look at Silicon Valley Bank that in 10 hours, the deposits were drained, that was **a shock to the system that is unknown to most management teams currently in their seats**.

So you clearly got this shock effect, and then **people started looking at their own balance sheets and wanted to make sure that they've got the right allocations and the right liquidity as needed**.

That shock effect, I would say, is largely over now.

Banks feel confident that they can proceed with the right liquidity levels they need right now, so we see people moving away from paying attention to that back to more strategic elements.

The early indications are that in second quarter, we begin to see deals coming loose and is moving down the pipelines again. The people are meeting with us. They're willing to see us on site.

And as you know, just from inside, they're willing to travel and come see us.

So we feel that the worst is behind us and **we will see a slight improvement in second quarter and then a pickup in third and fourth quarter.**"

At the same time, nCino also turned in FCF of US$30 million for its latest quarter, a sharp reversal from last year's free cash outflow of US$3 million.

To top it off, Naude also noted that 30% of bank operating systems are leveraging its nIQ solution.

As we highlighted in our June 2021 case study, nCino's Bank OS acts as a data hub to bring together disparate data sources and systems. From there, nIQ uses artificial intelligence (AI) and machine learning to help banks to increase efficiency through automation and to provide insights.

Here's what we said back then:

"nCino has introduced nIQ as a new service in late 2019.

We think that this move is important both from a defensive standpoint (which we will discuss in the risk section) and a competitive standpoint.

As nCino's machine learning capabilities are trained with more and more data, it will become harder for competitors to match."

We believe this statement continues to ring true.

It's not a bed of roses, though.

Customer churn is expected to be elevated in FY24, coming in at 6%, a step higher than its historical norm of between 2% and 3%.

Naude added:

"While all segments recognize the importance of modernization, **buying propensity in Q1 differed between these segments**.

For example, **community banks, which we define as those with assets below $10 billion, appear to have been relatively unaffected by liquidity concerns.**

Regional banks, with assets between $10 billion and $100 billion, have seen slightly more impact, although those without exposure to unsecured deposit concentrations have continued to perform well.

It's within the U.S. Enterprise segment, those above $100 billion assets, where we have seen the most impact which caused lengthening sales cycles, particularly with larger sales opportunities."

Last but not least, we cannot ignore the chatter in June where nCino was rumoured to be exploring a potential sale.

Shares have rallied on this news but nothing has been confirmed by the management team.

Here's the thing:

1. If a takeover happens, there is a high possibility we will get back to parity on our cost basis.

2. As investors, we will not be buying more for the sake of a rumoured sale. Simply said, this is not the game we want to play.

Given the uncertainty, we are leaving nCino in the Conviction Level 2 basket.

Growth Trailblazers : Conviction Level 2

Okta (NASDAQ: OKTA)

Okta is a story of big ambitions coming up against reality.

Co-founder and CEO Todd McKinnon envisions Okta becoming one of the five first-class cloud platforms that truly matter.

That's not all.

In the first quarter of the fiscal year ending 31 January 2022 (1Q'FY22), Okta projected that its revenue would grow to US$4 billion by FY26, implying a compounded annual growth rate (CAGR) of over 35% between FY22 and FY26. The platform company also expects to achieve an FCF margin of 20%.

But as we will soon learn, turning McKinnon's vision into reality has proven to be far harder than it looks.

In March 2021, Okta announced the acquisition of Auth0 for US$6.5 billion, funded by Okta shares. The transaction closed in February 2022, with Okta getting an immediate boost in revenue as a result.

We covered the acquisition details HERE and HERE.

Within six months of the acquisition, the problems started to appear:

1. The troubles started in early 2022 when Okta suffered a security breach due to its third-party vendor, Sitel. While there was no discernable impact on its business, the event was an embarrassment for a company providing security solutions.

2. The first sign of macroeconomic headwinds started appearing with IT budgets tightening and sales cycles lengthening.

3. The sales team started experiencing higher-than-usual attrition. In short, the Auth0 integration was not working out, as we detailed HERE.

4. To add to its woes, in 1H'FY23, FCF turned negative at US$13.1 million, a sharp reversal from the previous year's positive FCF of US$49.1 million.

To top it off, Okta backed away from its FY26 revenue target, saying it is being re-evaluated. We have not heard an update on this metric since then.

So, where does it leave us today?

Well, there is good news and less-good news.

Let's start with the positive:

1. Okta has turned the corner over the integration issues it faced last year. In its latest quarter (1Q'FY24), McKinnon said sales team attrition has decreased for three quarters in a row and is at its lowest level in two years.

2. Revenue from customers with an annual contract value (ACV) of US$100,000 and US$1 million is showing strength, growing 23% year on year and 40% year on year in 1Q'FY24, respectively. Trivia: OpenAI is an Okta customer.

3. Gross retention is in the "mid-90s" range while its dollar-based net retention rate (DBNR) for the trailing 12 months (TTM) came in at 117%, a respectable result.

4. Okta Identity Engine (OIE), an upgrade from Okta's classic engine, has been adopted by over 40% of existing Workplace customers.

5. Speaking of new solutions, Okta Identity Governance (OIG) is showing strong traction, signing up hundreds of customers in its first six months while Okta Privileged Access (OPA) is expected to be generally available at the end of 2023.

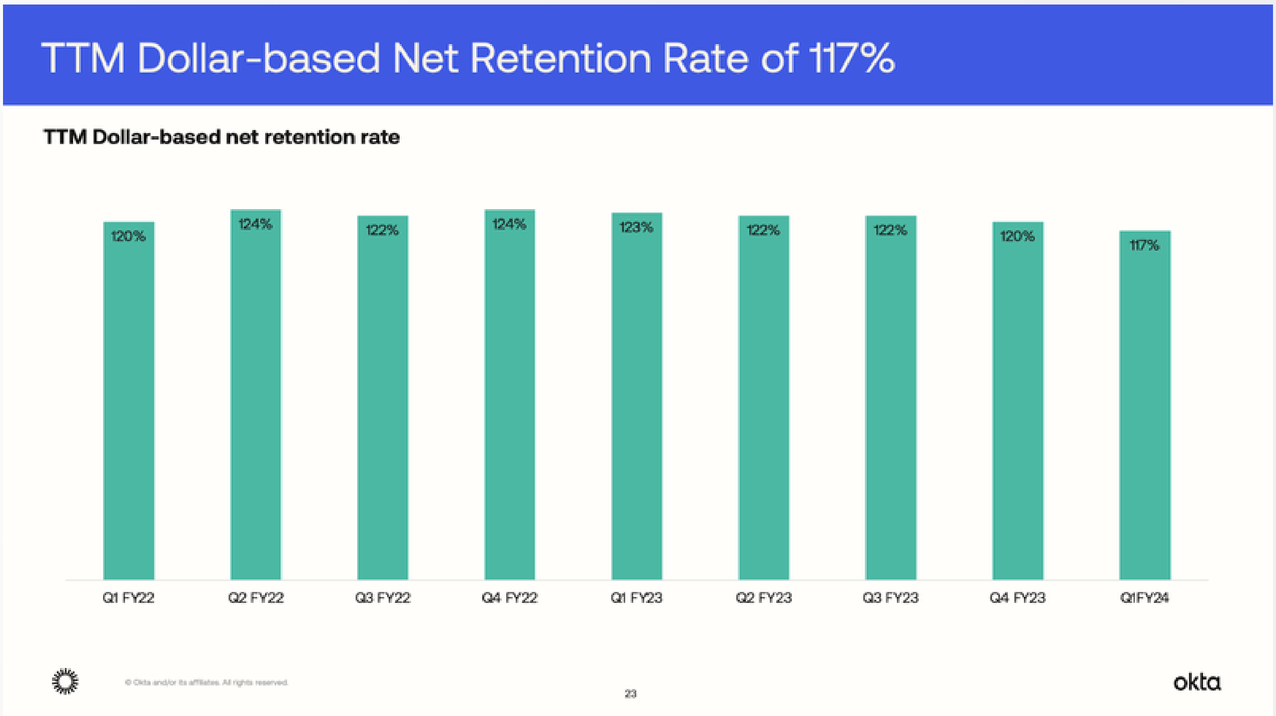
6. Finally, Okta has also reigned in share dilution, limiting its outstanding share growth to 3.5% in FY23. The SaaS firm has committed to keep dilution down to between 2% and 3% over the long term, starting from FY24.

On the flip side, there are headwinds to consider.

For starters, while Okta's DNBR of 117% is commendable, this metric has been on a steady downtrend for the last two quarters.

The main culprit is the lower upsell rate as customers are not expanding the number of seats at the same rate as the past. Customers are also requesting for shorter contract terms, a sign of hesitancy.

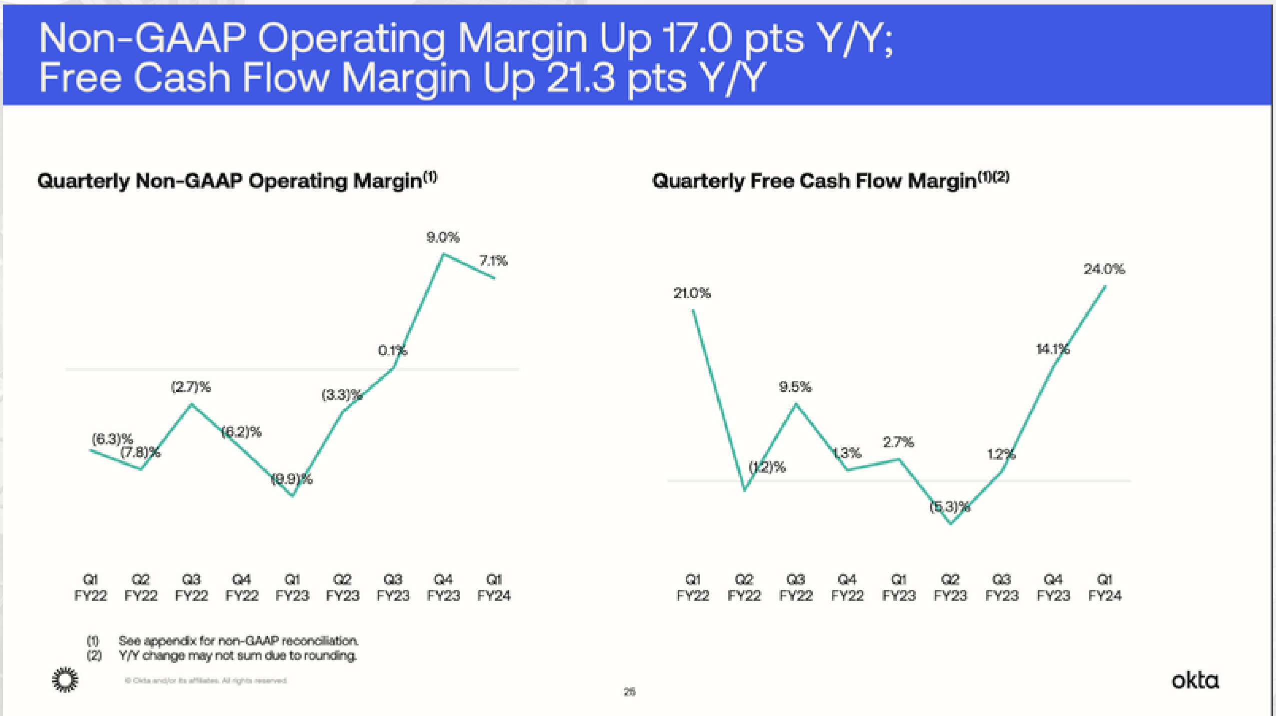
According to Okta, macroeconomic headwinds are behind this slowdown.



Source: Okta's earnings presentation

Furthermore, Okta is expecting to achieve a 12% FCF margin for FY24.

While this ratio is higher than its 4Q'FY23 projection of 10% FCF margin, it is still some ways away from its previous projection of 20%.



Source: Okta's earnings presentation

In all, Okta's story is a little bit mixed at the moment.

We do think that the positives outweigh the negatives, as it stands. For that, Okta earns a Conviction Level 2 rank and will remain as a Growth Trailblazer.

Growth Trailblazers : Conviction Level 3

Coinbase (NASDAQ: COIN)

From our September 2021 case study HERE, we stated that the crypto industry was nascent.

In fact, we suspected that whatever we wrote could prove to be obsolete over time, given the rapid changes and vulnerabilities in the industry.

Since then, we have been on an extreme roller coaster ride.

And that's putting it mildly.

Consider these two statistics:

1. In 2021, Coinbase saw its revenue soar by over 573% year on year from US$1.1 billion in 2020 to US$7.4 billion in 2021.

2. Then, things rapidly headed south, and sales tanking 57% year on year in 2022 to US$3.1 billion.

No CEO, in our mind, would have sailed through these two years above without making any mistakes.

Let's not forget about the high-profile collapse of TerraUSD and its associated token LUNA back in May 2022 which knocked the wind out of the sails for crypto enthusiasts.

To rub salt in the wound, the appalling bankruptcy of exchange-operator FTX, along with hedge fund Three Arrows Capital and lenders BlockFi, Celcius Network and Voyager Digital, has raised questions over the legitimacy of the industry.

Put all of the above together and you get a sense of what the company is coming up against.

Indeed, even with over a decade of industry experience, Coinbase CEO Brian Armstrong was forced to dramatically cut back on headcount (twice!) and shut down multiple non-core projects.

To top it off, the US Securities and Exchange Commission (SEC) has filed charges against Coinbase, alleging that it is operating as an unregistered securities exchange, broker, and clearing agency.

Separately, there were 13 charges filed against Binance, Coinbase's competitor, and its founder Changpeng Zhao.

Coinbase's lawsuits came as a surprise.

In our case study HERE, we said Coinbase has always put compliance at the forefront and committed itself to helping the government shape regulations for the crypto agencies.

But it takes two hands to clap.

From what we know:

1. Coinbase has made efforts to engage with the US SEC prior to the charges but to no avail.

2. Armstrong also argues that the SEC reviewed its businesses and allowed it to be listed in 2021.

3. Coinbase intends to defend itself in court.

Now, if you are finding it hard to wrap your head around all the above, you're not alone.

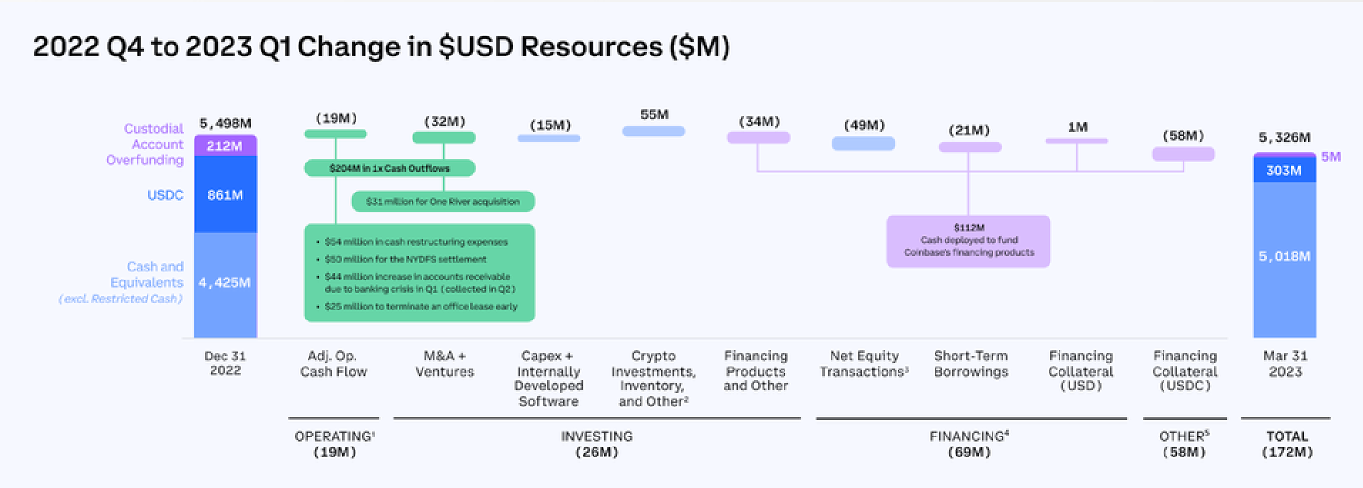
So, let's cut to the chase and focus on what we know.

Financial standing

To be sure, Coinbase has never been in any financial trouble.

As of 31 March 2023, the company had a little over US$5 billion in cash and cash equivalents. There is also another US$303 million in USDC stablecoins which we have not considered as part of its cash pile.

On the other end, Coinbase also had US$3.4 billion of debt.



Source: Shareholders' letter 1Q'23

Monitoring the cash position, we think, is the best way to determine whether the business is still on solid ground.

Assets on platform (AOP)

With trading activities down significantly compared to 2021, Coinbase's AOP provides a view of whether it remains a popular platform.

Certainly, the value of AOP has declined from its high of US$278 billion at the end of 2021 to US$80 billion at the end of last year, as shown below.

						FULL-YEAR	
ASSETS ON PLATFORM ($B)	Q4'21	Q1'22	Q2'22	Q3'22	Q4'22	2021	2022
Consumer	141	123	47	51	40	141	40
Institutional	137	134	49	51	40	137	40
Total	**278**	**256**	**96**	**101**	**80**	**278**	**80**

Source: Shareholders' letter 4Q'22

For 1Q'23, Coinbase registered an upturn with AOP coming in at US$130 billion, up almost 63% quarter on quarter from end-2022.

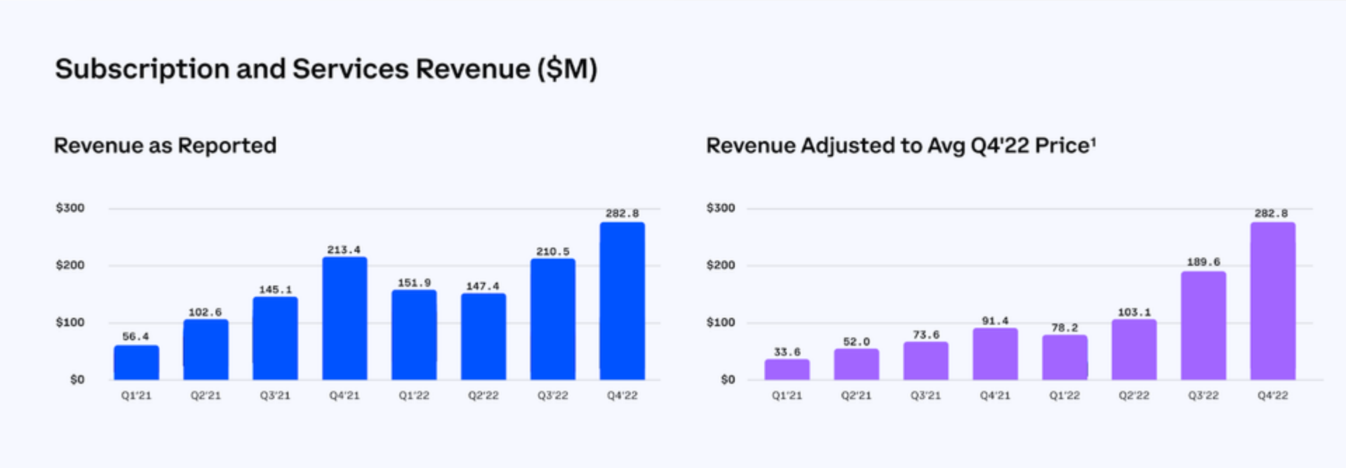
Over three-quarters of this gain was attributed to rising crypto prices.

Recurring revenue

Like it or not, Coinbase's fortune is still tied to cryptocurrency prices.

The most discouraging diagram is the one below, shared during its 4Q'22 shareholder letter.

As you can see, the reported revenue for its subscription and services remains largely tied to cryptocurrency prices. While this segment's revenue is less volatile, the ups and downs over the two-year period below do not suggest that it is recurring.



Source: Shareholders' letter 4Q'22

As our original investment thesis rests on Coinbase's transition from transaction-based revenue to recurring revenue, the uncertain progress in this segment is a cause of concern.

Will recurring revenue continue to be elusive?

We don't know, and that's why it's a Conviction Level 3 stock.

Before we close, we should add that Coinbase has really stepped up its product development which we covered in detail HERE, HERE and HERE.

What's missing, in our eyes, is the sustainability of its growth, above all else.

Simply said, show us proof.

Growth Trailblazers : Conviction Level 3

Sea Limited (NYSE: SE)

When Sea Limited debuted in the Smart All Stars Portfolio in February 2021, the business was firing on all cylinders:

1. Digital Entertainment (DE, including Garena) was the company's cash cow, boasting a rising number of quarterly active users (QAU) and quarterly paying users (QPU). Between 2016 and 2020's third quarter (3Q'20), QAU and QPU had risen by over 12-fold and more than 13-fold, respectively.

2. Digital Commerce (DC), which houses Shopee, was fast becoming the eCommerce platform of choice within South East Asia, even outpacing AliBaba's (NASDAQ: BABA) Lazada.

3. Finally, the third division, Sea's Digital Financial Services arm (SeaMoney), had every reason to succeed, given its existing user base at both Garena and Shopee. For a deeper explanation, check out our Portfolio Spotlight (Fintech) Lesson #2 HERE.

4. For 3Q'20, the Singaporean company posted a TTM FCF of US$70 million.

5. As of 30 September 2020, Sea had a net cash position with US$3.55 billion in cash and short-term investments and US$1.9 billion in borrowings and convertible debt.

But as we will soon find out, the years of rapid growth came at a price.

Buoyed by the pandemic boom, Sea became undisciplined in its spending.

The previous areas of strength started to weaken.

1. In 3Q'21, the DE division's QAU and QPU growth showed signs of normalisation. Then, in the following quarter (4Q'21), QAUs fell for the first time since the company went public.

2. We expressed concern as DE was the cash cow supporting the other two unprofitable divisions.

3. Tellingly, FCF turned negative for the year, leading to an outflow of US$600 million for 2021.

Initially, Sea persisted in investing for growth, projecting that Shopee and SeaMoney will collectively become self-sufficient by 2025.

The company was even willing to tap on its cash hoard to fund its spending spree.

That was in March 2022.

By September 2022, six months later, CEO Forrest Li owned up and pulled the plug on the company's wanton spending culture.

In a candid letter to his employees, he said (snippet below, bolded for emphasis):

"**We can now see that this is not a quickly passing storm: these negative conditions will likely persist into the medium term**.

Looking at the landscape ahead, the leadership team and I are making some decisions to help us not just survive this storm, but come out of it in as strong a position as possible.

Our number one objective for the next 12-18 months is achieving self-sufficiency.

This means achieving positive cashflow as soon as we can.

This is how I want Sea to emerge from this storm: in a position of certainty and independence, fully able to choose our own path.

To achieve this, we need to do two things:

1. **In the immediate term, we must find every way we can to reduce our operating costs**. The more cash we save each day, the more time we can buy ourselves to weather out this storm. Every bit counts.

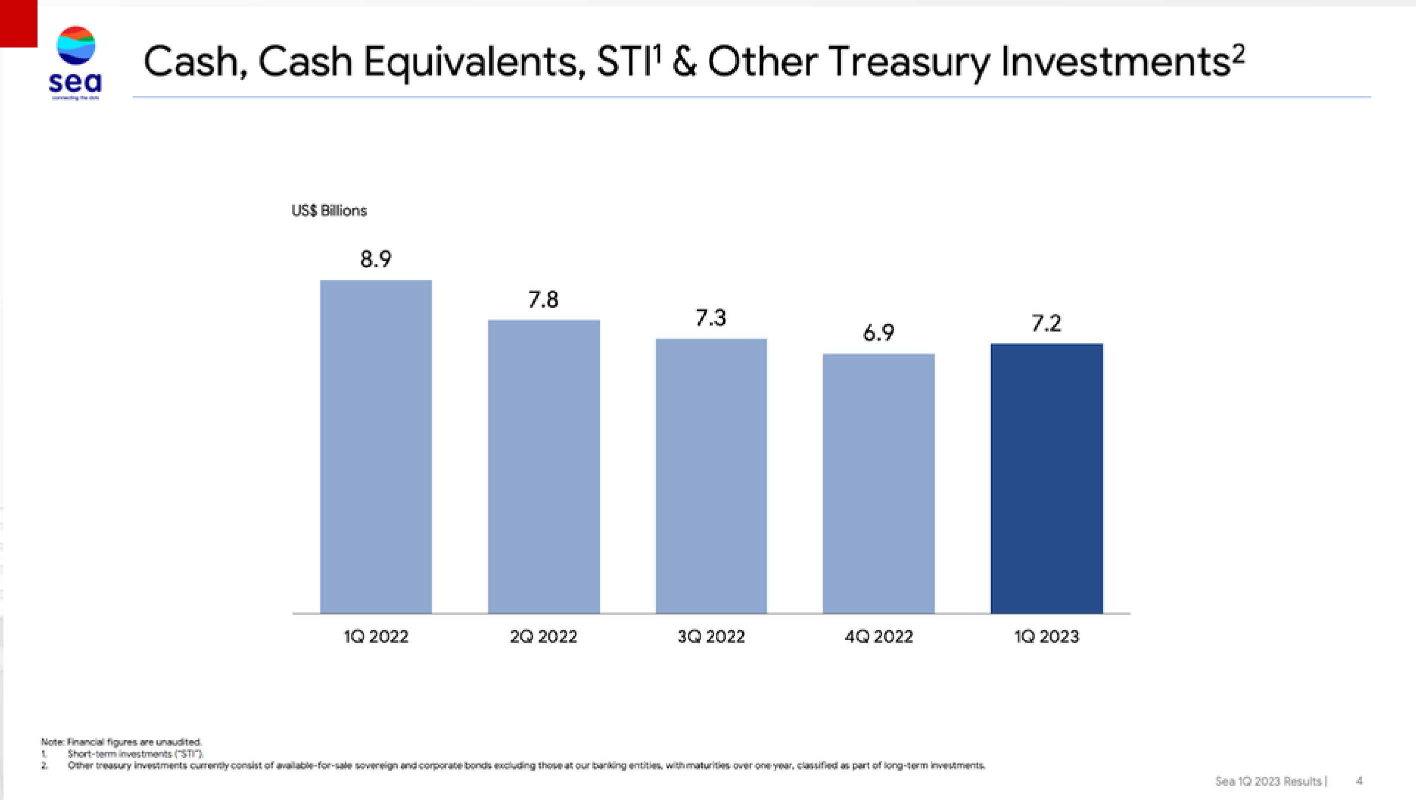
2. **Now and into the long term, we must establish a cost-sensitive culture across our organisation. In the past, we have focused on growth first, and sometimes growth at all costs.** This was not a wrong approach, as global conditions were ripe with opportunities then. But now that global conditions have changed, we too must adapt."

We will give credit to Li for admitting that the company had slipped into a “growth-at-all-cost” mentality and owning up to the error. Economic conditions had indeed worsened in 1Q’22 and 2Q’22 and it was time to reign in its old free-spending culture.

More importantly, Sea made good on its word, recording positive free cash flow in 4Q’22, a surprisingly fast result.

You can catch our deep dive review HERE.

Then, in 1Q’23, its cash position grew for the first time since 3Q’21.



Source: Sea’s 1Q’23 earnings presentation

As of 31 March 2023, Sea had US$8.4 billion consisting of cash and cash equivalents (US$6.1 billion), short-term investments (US$506 million), and long-term investments (US$1.8 billion).

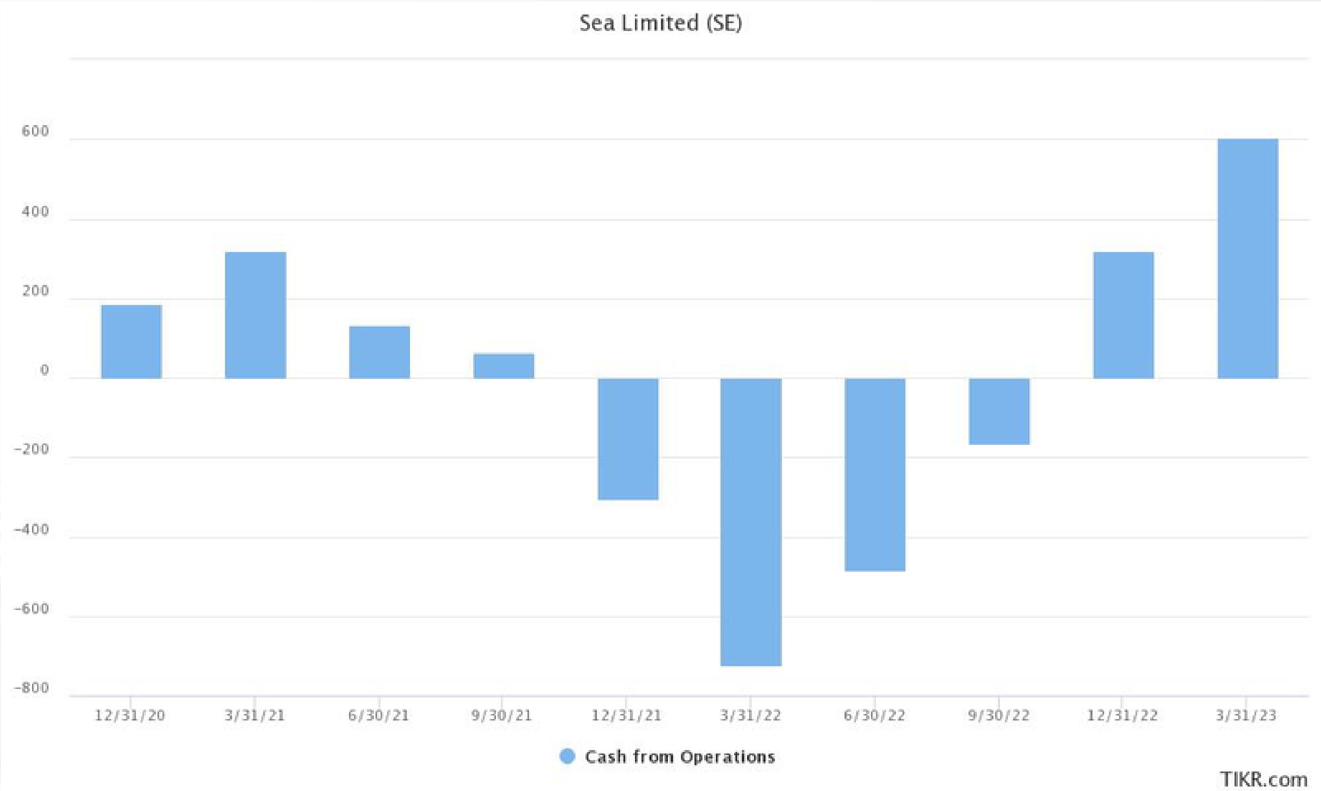
The company also had around US$3.4 billion in convertible notes and US$102.5 million in borrowings.

Furthermore, Sea turned in another quarter of positive free cash flow.

1. For 4Q'22, the Singaporean company generated close to US$320 million in operating cash flow while keeping its capital expenditure down at around US$152 million, giving an FCF of US$167 million.

2. For 1Q'23, Sea delivered US$606 million in operating cash flow and spent US$101 million in capital expenditure, earning it an FCF of US$505 million.

The positive operating cash flow was a welcome sight after four consecutive quarters of negative figures.



Source: TIKR

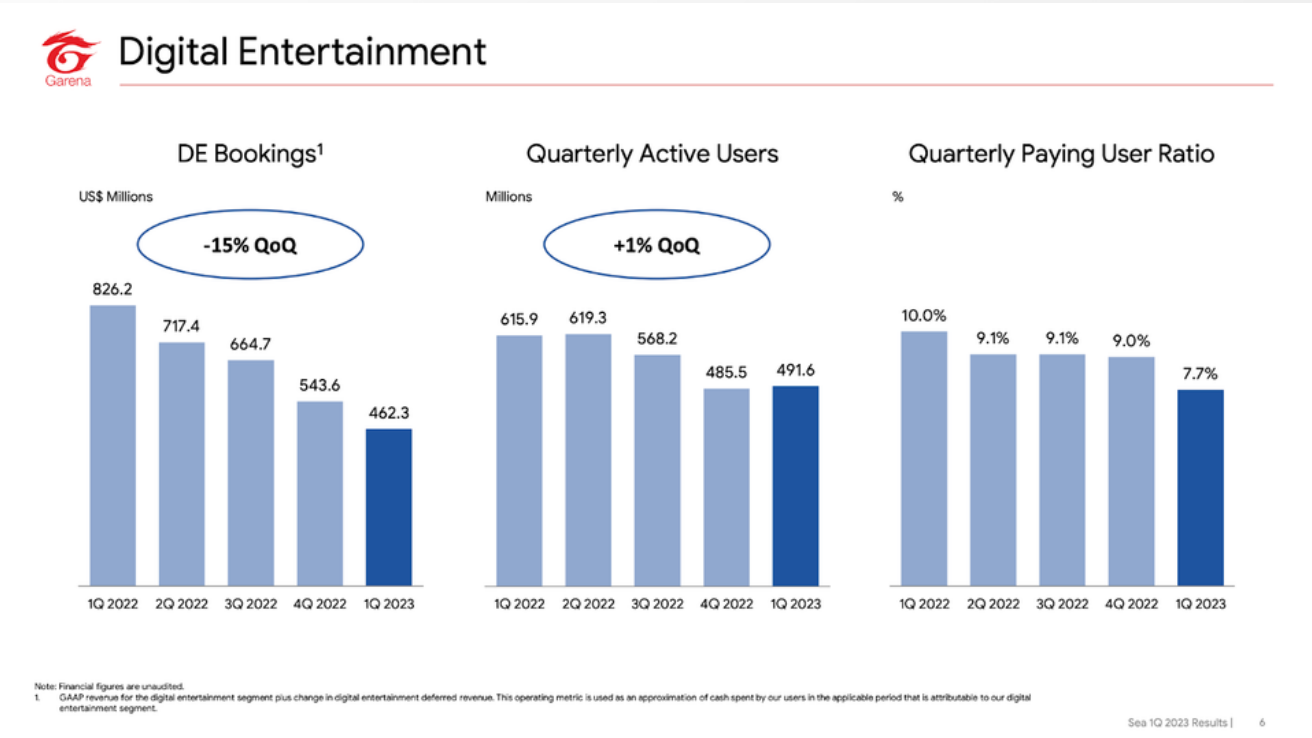
So, if all of the above sounds good, why is Sea ranked as a Conviction Level 3 stock?

Well, here are our thoughts:

1. While the turnaround to positive FCF was impressive, it came at a steep cost. In 4Q'22, Sea aggressively cut down its marketing costs to the point where its gross orders fell while its gross merchandise volume flatlined.

2. What we want is sustainable, profitable growth. Whether or not Sea is able to deliver profits AND grow still needs to be proven. We need to have a line of sight on how this combo can be achieved.

3. QAU appears to have stabilised in 1Q'23 but it's too early to tell (see slide below). In addition, it is unclear whether DE will ultimately turn into a hit-based business (read: lumpy revenue).



Source: Sea's 1Q'23 earnings presentation

In short, there are too many IFs at the moment — hence making Sea a Conviction Level 3 stock.

A SHORT NOTE BEFORE WE CLOSE ...

The Milestone Review #1 is over but our work is far from done.

We have spent three months reviewing all our work.

From here, our job, as investors, is to validate what we laid out in the review.

For instance, there are six companies in the penalty box today. All of them will be on a tight leash as we review their latest earnings.

Don't be surprised if the Smart All Stars Portfolio chooses to sell these stocks before 2023 is over.

Similarly, for the Conviction Level 2 stocks, we may choose to sell if we deem that there are better places to put our money to work.

In short, Milestone Review #1 has laid out the road map.

Now comes the real work of validation, and if needed — further action to buy more or sell.

Until next time,
Chin

Chin Hui Leong owns shares of Adobe, Alphabet, Amazon, American Tower, Apple, ASML Holdings, Atlassian, Block, Booking Holdings, Coinbase, DocuSign, Doximity, Fiverr, Illumina, Intercontinental Exchange, Intuit, lululemon, MarketAxess, MercadoLibre, Meta Platforms, Microsoft, MongoDB, nCino, Netflix, PayPal, Roblox, S&P Global, Salesforce, Sea Limited, ServiceNow, Shopify, Synopsys, Tractor Supply, Veeva Systems, Visa and Zoom.

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