GrowthLine®

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Welcome to Disruptive Change

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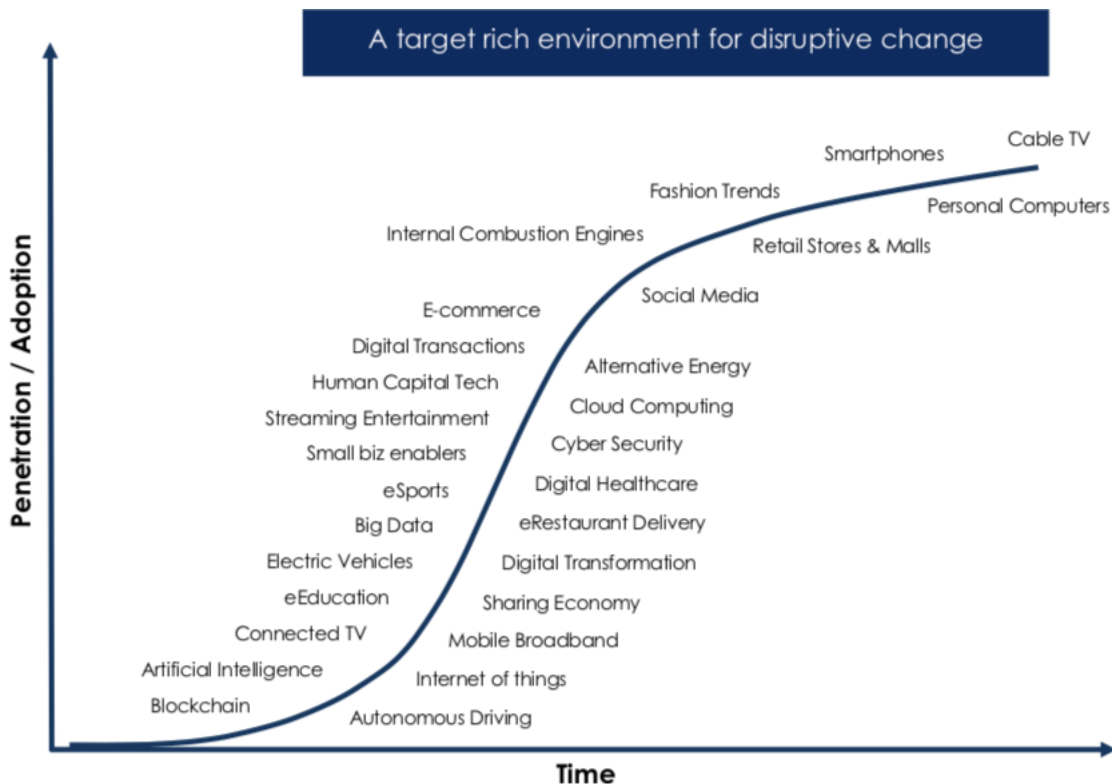
We are in an era of disruptive change. In our Growth Cycle Investing framework, we identify disruptive, investable long-term trends, map them and those companies affected along the adoption curve to help us determine winners and losers from the trend. Below we map some investable themes that we have identified and are focused on and discuss several that were impactful in 2019.



Streaming video and connected TV. The transition to on-demand, streaming media is still in its early stages. Netflix was the pioneer, starting its streaming service in 2007, and the next decade should witness streaming and connected television adoption move up the steepest part of the adoption curve. Roku, which we have discussed previously, is a beneficiary of this trend and was a meaningful positive contributor to our results in 2019. Another more recent investment that is a beneficiary of this trend is

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The Trade Desk. As media viewing transitions to digital, advertisers have a problem in how to reach those consumers. As an example, industry surveys estimated that nearly 29% of television viewing hours in 2018 were watched streaming yet streaming captured only 3% of video advertising dollars. Over time, those advertising dollars will follow the viewers. The Trade Desk is a leader in helping advertisers reach those consumers. The Trade Desk is connected to thousands of digital media platforms, from independent web sites, to Spotify, to Amazon's Fire TV. Advertisers, like Ford Motor Company, use The Trade Desk to get its advertisements in front of its target demographic. Ford, for example, can specify that it wants specific ads put in front of males between the ages of 18 and 40. This method of placement is called programmatic advertising, using the digital footprint of the targeted consumer to get the right ad to the right person. The previous method was more of a guess, with media and advertising executives suffering from the conundrum that they know half of their advertising was ineffective, but the problem was in knowing which half. With programmatic advertising, you know who has received the ad.

Digital Transformation. Global businesses have embraced converting most of their business processes from manual to digital. We are invested in several companies that are benefitting from this trend, as well as opportunistically shorting companies being disrupted by it. Salesforce.com was the pioneer of this concept in the late 1990s and began with the idea of putting all of a company's customer and sales information on the internet, now called the Cloud, so that salespeople could access the information from their laptops and cell phones. This made them much more productive and launched the movement toward transforming business processes to the digital world. Today, companies are looking at every business process, from marketing, to accounting, logistics or even how to calculate, collect and file sales tax. Most business processes will transition to digital over time and many of those transitions are in their early stages. Large aggregators of the digital transformation like Salesforce.com, Adobe and Microsoft have many years of growth ahead facilitating this transformation. There are also quite a few smaller, specialized companies that we are focused on that are leading different areas of these transformations.

Insperity Follow Up. Our investment thesis for Insperity turned out to be wrong. Insperity is a Professional Employment Organization (PEO) that works with small and medium sized businesses to get better access and pricing for healthcare and other human resource benefits. The company has seen robust growth over the past decade. Insperity does take risk, however, underwriting its clients' healthcare insurance. Historically, that created some volatility in the company's results. Yet, over the past decade, with increasing scale and sophistication, the incidences and impact of insurance events had declined significantly, allowing the company to become valued more richly because of its consistency. That consistency ended in 2019, with the second and third quarters each having a 'once in a decade' insurance loss. We underestimated the risk of underwriting volatility and sold the position for a loss.

New Opportunities. Energy, and oil producers in particular, is an area where we have recently been opportunistic. We believe domestic oil producers are in the early phase of a new favorable cycle that is likely to last for several years. My history of investing in growth companies in the energy sector goes back to 2003. Over the subsequent years, what I learned is that growth investing in energy can be quite rewarding so long as one recognizes the prevailing pricing regime. Oil producers are cyclical in how they are affected by the cycling between the perception of scarcity and abundance. The years 2003 through

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2014 were governed by a scarcity regime, where oil prices generally worked their way higher, and oil producers gained richer valuations as they continued to grow production. The reaction to this was innovation, like shale oil fracking, and significant increases in capital spending from energy companies to grow production. From 2014 through 2019, we were in an oil abundance regime, with fears of oversupply largely driven by the success of American shale oil and concerns over peak demand with the growth of the green movement. This period saw oil prices trending downwards, energy company valuations becoming depressed, and we witnessed the largest reduction in capital spending for energy companies in the history of the industry. The next phase, which I believe is starting now, is a movement back toward a scarcity regime as the effects of the last five years of spending cuts and the lower oil price work their way into the industry.

In our Growth Cycle Investing process, we map each company along its unique adoption curve. We broadly group them into three categories based on their stage of life and position along the curve. Generally speaking, Venture Growth means the addressable market is starting to become clear and there are typically quite a few companies competing for that market opportunity. Earlier stage software companies are often in this category. Emerging Growth is when the addressable market is largely defined and there are a handful of competitors vying for dominance. Streaming TV company Roku, which competes with Amazon and Google for this market is a good example. Maturing growth is when the market leadership is fully established, but there is still plenty of growth ahead. Facebook's dominance in social media is an example. At the risk of oversimplifying, companies nearer to the top of the curve typically have less volatility and risk of material disappointment, but also less opportunity for long term appreciation.

The GrowthLine Team

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