October 2020

Dear Investor,

THIRD QUARTER OF 2020

Although our primary communication is an annual letter, we share changes to your portfolio and developments at Capensis Capital on a quarterly basis.

Investment Performance

This letter is designed to be read in conjunction with your quarterly investment statement which contains all the financial information relevant to your account. As always, feel free to contact us if you would like to discuss your portfolio.

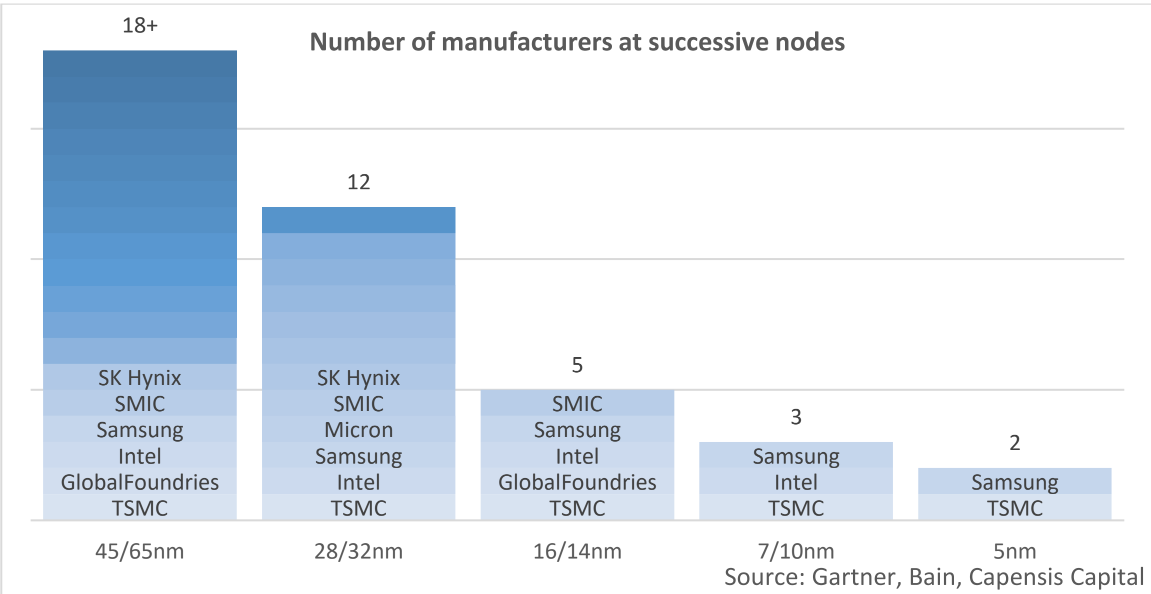
Portfolio Updates

We added three new companies to the portfolio over the past quarter. Continuing on from the discussion we had in our previous letter about the opportunity in semiconductors, we've included TSMC and Micron as new investments exposed to the long-term potential of this industry. The third new investment is Twitter.

- **Taiwan Semiconductor Manufacturing (TSMC)**

TSMC is the largest independent semiconductor foundry and the world leader when it comes to leading-edge semiconductor manufacturing. As the name suggest, it is headquartered in Taiwan, but the reach of the company extends far beyond this island.

The consolidation in the semiconductor supply chain is most evident when one considers foundries (also known as fabrication plants, or fabs). Semiconductor manufacturing processes develop along successive technological nodes and the number of companies able to manufacture at the most advanced node (also known as the leading edge) has reduced with every progression.



As technology advances, so too does the cost and complexity of manufacturing smaller components on a silicon wafer. Over the years, the semiconductor landscape has developed into large Integrated Design & Manufacturing or IDM companies (Intel and Samsung) and an ecosystem of fabless designers and manufacturers (including Qualcomm, Nvidia and AMD) who outsource their production to contract manufacturers.

2nd Floor, Josephine Mill, 13 Boundary Road, Newlands, 7700 | PO Box 51868, Waterfront, 8002, South Africa | Tel: +27 (21) 276 3450
email: info@capensiscapital.com | www.capensiscapital.com
Capensis Capital (Pty) Ltd. Reg No 2016/382805/07. Authorised financial services provider. FSP 47674
Director: PJ Bosman, HP Vermaak

Fabs are the capital-intensive part of the chip production process and economies of scale was one of the benefits IDMs had over the competition. However, the sharing economy is evident in this industry and the growth of the likes of TSMC has allowed many smaller, fabless players to compete with the larger IDMs.

Furthermore, it is important to note that TSMC went from being an independent manufacturer offering a commoditised manufacturing process to a technology leader. TSMC achieved this by investing in research and development in close collaboration with their clients, capital investment and adopting new manufacturing technologies faster and better than the other foundries. TSMC has never strayed from their focus on enabling and never competing with clients, creating a win-win environment for everyone in their ecosystem. The resulting success has disrupted the advantage that the IDMs had to such an extent that even Intel has suggested that they might outsource the newest node of manufacturing to TSMC.

TSMC's importance has been increasing, both within the semiconductor industry and from a geopolitical perspective. There is an increasing field of companies involved in the design of microchips, all of which outsource production to contract manufacturers. So too has there been an increase in the range of customers and end users of its products as the world continues to digitise. Manufacturing continues to be one of the bottlenecks in meeting this demand, and TSMC remains the sole independent fab at the leading edge. America's policy of limiting the access that Chinese companies have to semiconductor technology has further increased the importance of TSMC to keep the global supply chain running smoothly.

TSMC has achieved its strong position while maintaining a net cash position and delivering an ROE above 20%.

- **Micron (MU)**

Micron is one of the large memory chip manufacturers.

As repeatedly noted, we see enormous demand for semiconductors generally. To some extent, this is due to the explosion of data happening everywhere. However, for data to have value, it must be stored and processed. There are two main types of memory in use today: Volatile memory (DRAM) is used within devices to facilitate the processing of data, while non-volatile (Flash) memory is used to store data.

Memory chips are much more of a commodity compared to the processors. However, we feel that the market has improved to such an extend that the memory manufacturers currently offer an attractive investment opportunity.

The DRAM sector has consolidated, with Samsung, SK Hynix and Micron producing more than 90% of all chips. Increasing capital intensity and slower efficiency gains have made the barriers to entry higher in this industry. Recent cycles have shown that this oligopoly can be rational and is no longer in the business of aggressive expansion to take market share. DRAM supply growth is being kept below the memory demand growth which is creating a structural undersupply in the market. This bodes well for better profitability and less cyclicality in this commodity.

DRAM accounts for three quarters of Micron's business. The balance is Flash memory.

The Flash memory sector is less attractive than DRAM. There are more manufacturers active, the product is more of a commodity and there is a larger risk of new entrants. However, there have been some recent announcements in the Flash space which are indicative of an industry which is starting to consolidate. For example, Intel announced that they are selling their memory division to SK Hynix. The main beneficiaries of this transaction might be Micron and some of the other competitors, as it reduces the likelihood that SK Hynix would install additional capacity while integrating the acquisition.

The memory industry is at a trough in its cycle and we expect memory prices and ultimately margins to increase from here. We have bought your shares at a very attractive price compared to our through-the-cycle valuation of the business.

- **Twitter (TWTR)**

Twitter is the final new entry into the portfolio.

Twitter has built a platform that has become the primary resource for news and information, often directly from the actual source. It has taken over the role previously played by the likes of the Associated Press. Additionally, Twitter is increasingly becoming the platform where you can connect with your interests, rather than just with other accounts.

The company has invested in improving the platform and is taking action to make it safer. We see this as focusing firstly on the health of the platform and not immediate monetisation. However, we do understand that the company has rebuilt some of the crucial elements of the business that would enable it to increase its monetisation in the near term. Delayed gratification is often mispriced in the market.

The lock-down has led to a further move of advertising spending to online platforms, as well as a significant boost to active users on Twitter. If the business manages to retain these new users, we might see a permanent step change in the user base. Twitter has, in our opinion, a very underappreciated opportunity to improve its revenues and margins, particularly in a post-virus world where there is a return to product launches, sporting and other events.

Conclusion

It continues to be a pleasure and a privilege to manage your investment. Please do not hesitate to contact us if you have any questions regarding your portfolio.

Your partners in long-term value,

Paul and Henno

2nd Floor, Josephine Mill, 13 Boundary Road, Newlands, 7700 | PO Box 51868, Waterfront, 8002, South Africa | Tel: +27 (21) 276 3450
email: info@capensiscapital.com | www.capensiscapital.com
Capensis Capital (Pty) Ltd. Reg No 2016/382805/07. Authorised financial services provider. FSP 47674
Director: PJ Bosman, HP Vermaak

Disclaimer

This document is intended for the clients of Capensis Capital (Pty) Ltd. All data provided by Capensis, unless otherwise stated, is current as of 30 September 2020.

Capensis Capital (Pty) Ltd is an Authorised Financial Services Provider, regulated by the South African Financial Sector Conduct Authority. Registered office: 2nd Floor, Josephine Mill, 13 Boundary Road, Newlands, 7700.

More information about Capensis can be found at http://www.capensiscapital.com.

The value of your investments and the income from them may go down as well as up. It is possible that you may receive less than you invested. Past performance is not indicative of future performance.