

Industry 4.0

A lot has happened since we wrote *Rebound*, our last newsletter. The Capital Ideas Fund has rebounded well since the selloff in the first quarter. In the second quarter of 2020, DKAM performed well with a return of 22.4%¹ versus 17.0%² for the TSX Total Return Index.

Figure 1. DKAM Capital Ideas Fund LP Total Return Since Inception

	Total Return	Annualized Return
DKCI ¹	440%	15.4%
S&P 500 Total Return Index ³	241%	11.0%
S&P/TSX Total Return Index ²	88%	5.5%

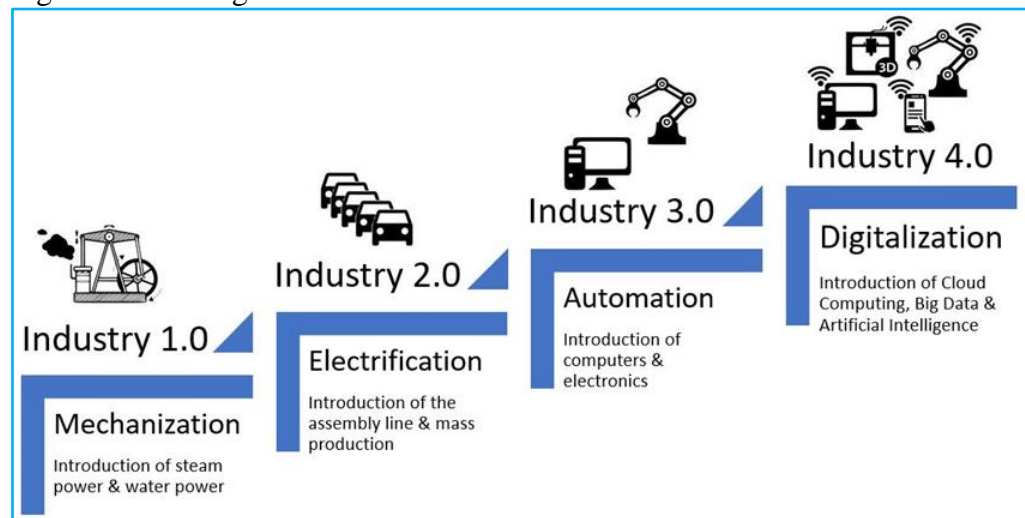
Since the stock market bottomed on March 23rd, large cap technology companies have performed extremely well and most are at, or near all-time highs. The rest of the stock market hasn't performed as well, with the average stock in the S&P 500 down 12% for the year as of June 30th, 2020. The strength in the technology sector is well deserved as economies, jobs, and personal lives are becoming more digitized, more connected, and more automated. The mixing of the digital and physical worlds continues to get more complex, and the depth of this relationship will only continue to grow.

We all remember that chapter in grade school history class when we learned about the Industrial Revolution. We see pictures of Dickensian factories and workers covered in soot, and learned how their lives were changed by big industry and the steam engine. Economies developed swiftly as societies moved from an agrarian focus to a manufacturing focus with the onset of new technologies. However, over time we also learned to call this the "First Industrial Revolution" as subsequent shifts had similar economic and societal impacts. Subsequent advances brought increased automation into our lives and businesses and, of course, the Internet changed the world forever. Now the arrival of a global pandemic, forcing the whole world to effectively work from home and demand digitization seemingly overnight, has now accelerated our need for digital tools. Thus, "Industry 4.0" refers to this next step of the Industrial

Revolution. All of our businesses and so many aspects of our lives now absolutely need to be conducted in an online digital space.

Phones, email, social media, and e-commerce have only become more essential to our lives and jobs, and as a result companies like Apple, Microsoft, Google, and Amazon have done well. However, it is not only the tech giants that are likely to grow. As one digs further into the industry, it becomes apparent how critical smaller technology companies are to daily operations, and how broadly they may operate. Starting in 2019, we started to see many more up and coming technology companies in the public markets. These emerging technology companies are impressive and are well-positioned to undergo transformational growth over the next few years.

Figure 2. The Stages of Industrial Revolution



Why are we talking about this now? After decades of investment, now is proving to be the time to for digital companies to prosper. In mature markets around the world, there is now robust infrastructure, a large install base of connected devices, and available bandwidth that has paved the wave for investments in software and services. COVID-19's impact on the digitalization of our society has further accelerated the implementation of new technologies and the breadth of usage.

- In 2000, only 7% of the global population was online versus 60% today (95% of North America)⁴
- The average internet connection speed in North America has improved by 1,900%⁵ over the last ten years
- The cost of cloud storage has dropped 85%⁶ over the past 10 years

The barriers for custom software and scale are now no longer major obstacles and the onset of Industry 4.0 has escalated our climb up the S-Curve.

Accelerated Trends

Netscape founder and venture capitalist, Andreessen Horowitz, coined the phrase “software is eating the world.” He refers to the digital disruption where software is taking over large segments of the economy. We could have written a newsletter on this topic last year or possibly the year before. Before COVID-19, the digital economy was already growing faster than the economy as a whole, but the pandemic has now even further advanced this phenomenon. The digital transformation has accelerated at a time when the rest of the economy has hit the brakes. In a world where interest rates and total growth dance around zero percent, the technology space benefits from a multitude of tailwinds that will enable future growth.

The pandemic has forced those resistant to change to shop online, work from home, adopt the cloud, establish an online presence, and use teleconference solutions. Many businesses realized they were not prepared for this shift, leading to large investments in both customer facing portals as well as back-office systems.

In the last 18-24 months, companies have gone from experimenting with technology, to being forced to start adopting at scale. Tech intensity refers to the rate at which firms adopt technology and this rate has accelerated recently.

“The world has changed. We’ve seen two years’ worth of digital transformation in two months.” Microsoft CEO, April 2020

“We are seeing first-hand the rush for offline businesses to market, transact, and fulfill online. We are seeing years of economic transformation jammed into weeks or months.” Tucows CEO, Q1 2020

“Businesses that once mapped digital strategy in one-to-three year phases must now scale their initiatives in a matter of days or weeks. The COVID-19 crisis seemingly provides a sudden glimpse into a future world, one in which digital has become central to every interaction, forcing both organizations and individuals further up the adoption curve, almost overnight.”

McKinsey, April 2020

During this pandemic, we have been speaking with more public company management teams than ever before. We continue to hear about management teams relying more on digital dashboards. In this environment especially, companies need to be able to aggregate their data in a reliable, timely, and accurate manner. This data then needs to be stored, protected, analyzed, disseminated etc. Depending on the size and complexity of the business, this process can involve 5-20+ external digital vendors.

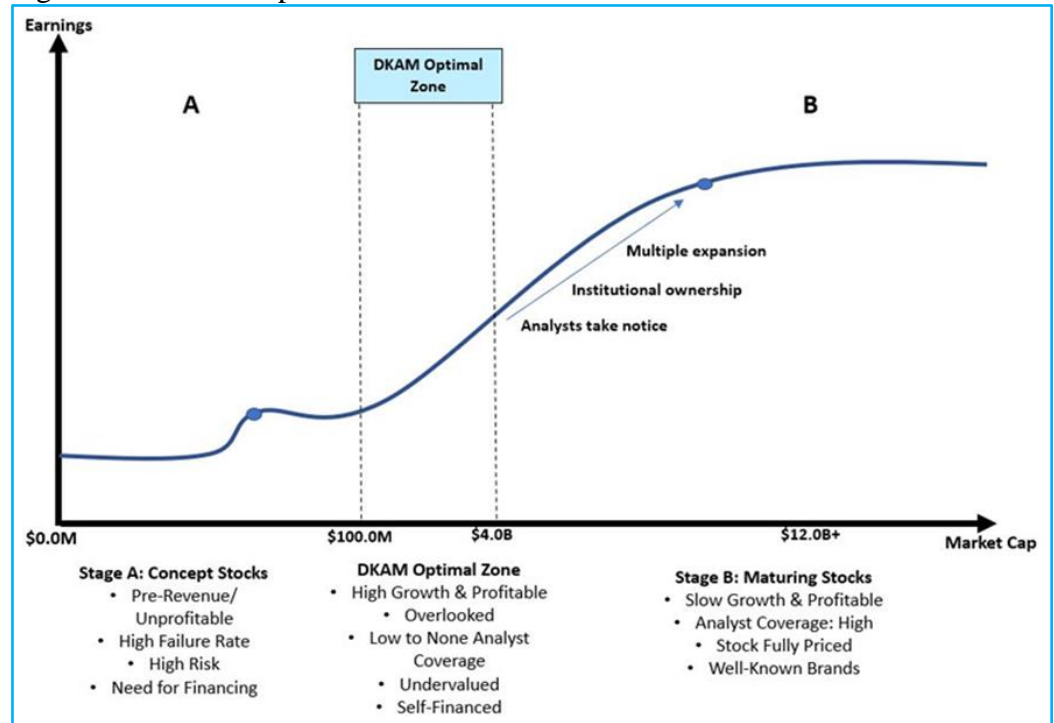
As investors, what's even more impressive is the economic profit and opportunities being generated by both parties in these partnerships. For most of the users, investment in technology isn't only a necessity but, in many cases, can also provide a phenomenal return on investment. For example, ServiceNow customers usually see a payback within six months and an ROI of at least 5x in the first full year. One CEO recently mentioned how his company can now onboard new clients in one day, while it previously took them up to 45 days. This phenomenon of suddenly doing more with less is akin to what happened during the past waves of innovation throughout the Industrial Revolution.

Big Companies Start as Small Companies

The digitization market is growing rapidly and is much broader than most assume. Of course, there are the large FANG (Facebook, Amazon, Netflix, Google) stocks that come to mind whenever someone mentions technology stocks. However, there are also thousands of smaller companies that play pivotal roles in Industry 4.0. There are plenty of smaller companies that benefit from Google, Facebook, Amazon, and Shopify doing well that don't require investors to pay up for the same high multiples.

We've been doing some online presentations with investors since we aren't travelling (if you'd like a copy of our most recent presentation, please feel free to reach out). We added figure 3 to our presentation because we have been speaking to some investors who are new to Donville Kent. We have always aimed to own high quality, small, emerging growth companies, and this aim is even more focused now. Small companies usually have a longer runway for growth and cheaper multiples because they are underfollowed. As an early investor, one gets to ride the wave of earnings growth combined with multiple expansion.

Figure 3.0 DKAM Optimal Zone



There is a great recent example of this dynamic at work. We started investing in MediaValet Inc. (CVE:MVP) after meeting with management and completing our due diligence near the end of 2019. MVP has an attractive software solution for digital asset management in the cloud and an accelerating growth profile. At the time, there was no analyst coverage and the company was too small for most investors to care. The stock continued to perform, reaching new highs in June, and then the company got their first sell-side analyst coverage. The analyst set their price target at \$3.00⁷, implying ~100% upside and the stock was up 20% over the next couple of days. For MediaValet specifically, but also for many of our other small cap investments, we expect them to continue to climb the market cap curve. Being able to meet, model, and analyze these businesses ourselves allows our investors to get exposure to the most promising emerging technology stocks.

Below is a quick rundown of some of the other digital investments currently in the Capital Ideas Fund.

Adcore (CVE:ADCO) – Offers online marketing software to small and medium sized businesses (SMB) which allows marketing dollars to get a better ROI. In April 2020, they started to gain traction in Asia and in June launched their regional office in Hong Kong, with an additional plan to sell and manage clients in mainland China. In the middle of July, they launched a new app for the Shopify App Store. It is our understanding that the pandemic delayed some of

their acquisitions, but we expect them to deploy their cashed-up balance sheet imminently.

MediaValet (CVE:MVP) – Offers a digital asset management software that is powered by AI technology. They saw a 30% increase in client usage during the hardest hit periods of the pandemic. They occupy a strong position in the market and are gaining traction. We expect strong growth for the foreseeable future if a larger player doesn't acquire them in the meantime.

Altigen (OTC:ATGN) – Is a Unified Communications as a Service provider (UCaaS). As workflow demands change, more businesses will need to adopt UCaaS solutions. These ensure employees and customers can collaborate more efficiently, whether at home, in the office, or on the road. Altigen has grown cloud revenues 200% in the last two years and they have a large growth opportunity as they integrate with Microsoft Teams.

Sangoma (CVE:STC) – Is also a UCaaS provider that has a slightly different product offering compared to ATGN. At this point, 70% of SMBs have not adopted UCaaS solutions. Sangoma recently raised a large amount of capital (which we participated in) and we predict they will use it to acquire a relatively large SaaS business that will bump up their recurring revenue profile.

Vitalhub (CHE:VHI) – Provides software focused on electronic medical records as well as patient flow efficiency. They have more than 40% of their market cap in cash, which they should be able to deploy to more than double the size of their business.

Dye & Durham (TSX:DND) – Is an up and coming software consolidator that completed one of the most successful IPOs in Canadian history which occurred in the middle of July. They provide critical workflow software for law firms and banks. They also have a history of integrating acquisitions well and will use their IPO proceeds to accelerate growth.

Tucows (TSX:TC) – Provides fast and reliable internet which has become a necessity for businesses' continuity in enabling remote work. Tucows operates and owns the infrastructure for Ting Fiber, a business that provides 50x faster download and 1000x faster upload speeds than the average internet provider. This business is 3x more profitable than their other lines of business and is growing at 85% YoY.

Pivot Technologies (TSX:PTG) – Benefits from a new management team which has significantly cleaned up the business and shored up the balance sheet. Pivot is a player in the edge computing market which benefits from some of the strongest secular tailwinds in the sector. Investors also get a large dividend along the way.

Enghouse (TSX:ENGH) – Offers a secure teleconference business that is used by hospitals (telehealth) and financial institutions, as well as other communication software services. Enghouse’s growth is accelerating while their balance sheet boasts a large amount of cash.

Final Thoughts

Many investors have short term concerns. The pandemic is obviously front and center in everyone’s minds, and likely will continue to worry many for the foreseeable future. However, by being bottom-up investors, we are able to sleep at night knowing that we have and will continue to find high growth companies in a low growth world. Some of these small, emerging companies will grow into the next large dominant players during the Industry 4.0 transformation. Since March, we have seen the large cap technology stocks rebound strongly, and it appears as though the small cap technology stocks are starting to do the same. We feel that the fund is well positioned to capture the upside we see coming for the remainder of 2020.

As always, we would like to thank the entire Donville Kent family, including all of our investors and employees. If you would ever like to discuss any investment related topics, always feel free to reach out.

J.P. Donville & Jesse Gamble

info@donvillekent.com

All estimates, projections, and calculations have been generated by DKAM. This does not constitute advice for personal investments but rather a breakdown of how Donville Kent approaches stock analysis.

1 Time weighted rates of return for Class A Series 1, net of all fees and expenses as of June 30th, 2020.

2 S&P TSX Composite Total Return Index is the Net Total Return version of the S&P/TSX Composite Index.

3 S&P 500 Total Return Index is the Net Total Return version of the S&P 500 Index.

4 [https://www.statista.com/statistics/617136/digital-population](https://www.statista.com/statistics/617136/digital-population-worldwide/#:~:text=How%20many%20people%20use%20the,in%20terms%20of%20internet%20users.)

[worldwide/#:~:text=How%20many%20people%20use%20the,in%20terms%20of%20internet%20users.](https://www.statista.com/statistics/617136/digital-population-worldwide/#:~:text=How%20many%20people%20use%20the,in%20terms%20of%20internet%20users.)

5 <https://www.businessinsider.com/internet-speeds-have-gotten-dramatically-faster-over-past-decade-2019-11>

6 <https://www.architecting.it/blog/aws-price-reductions/>

7 Bloomberg – Media Valet Rated New Buy at Eight Capital: PT \$3

DISCLAIMER

Readers are advised that the material herein should be used solely for informational purposes. Donville Kent Asset Management Inc. (DKAM) does not purport to tell or suggest which investment securities members or readers should buy or sell for themselves. Readers should always conduct their own research and due diligence and obtain professional advice before making any investment decision. DKAM will not be liable for any loss or damage caused by a reader's reliance on information obtained in any of our newsletters, presentations, special reports, email correspondence, or on our website. Our readers are solely responsible for their own investment decisions.

The information contained herein does not constitute a representation by the publisher or a solicitation for the purchase or sale of securities. Our opinions and analyses are based on sources believed to be reliable and are written in good faith, but no representation or warranty, expressed or implied, is made as to their accuracy or completeness. All information contained in our newsletters, presentations or on our website should be independently verified with the companies mentioned. The editor and publisher are not responsible for errors or omissions. Past performance does not guarantee future results. Unit value and investment returns will fluctuate and there is no assurance that a fund can maintain a specific net asset value. The fund is available to investors eligible to invest under a prospectus exemption, such as accredited investors. Prospective investors should rely solely on the Fund's offering documentation, which outlines the risk factors in making a decision to invest.

The S&P/TSX Composite Total Return Index, the S&P 500 Total Return Index, and the Russell 2000 Total Return Index ("the indexes") are similar to the DKAM Capital Ideas Fund LP ("the fund") in that all include publicly traded North American equities of various market capitalizations across several industries, and reflect both movements in the stock prices as well as reinvestment of dividend income. However, there are several differences between the fund and the indexes, as the fund can invest both long and short, can utilize leverage, can take concentrated positions in single equities, and may invest in companies that have smaller market capitalizations than those that are included in the indexes. In addition, the indexes do not include any fees or expenses whereas the fund data presented is net of all fees and expenses. The source of the indexes' data is Bloomberg.

DKAM receives no compensation of any kind from any companies that are mentioned in our newsletters or on our website. Any opinions expressed are subject to change without notice. The DKAM Capital Ideas Fund, employees, writers, and other related parties may hold positions in the securities that are discussed in our newsletters, presentations or on our website.