

Following a strong September quarter, we take this opportunity to update investors on Montaka's current positioning and how we are viewing recent global developments. **We continue to believe that the quality and upside potential of Montaka's portfolio has never been higher. And the powerful themes to which Montaka's portfolio is meaningfully exposed, we believe, will drive Montaka's long-term compounding through our noisy and rapidly evolving world.**

Many of Montaka's underlying investment themes are not particularly new, but they are highly reliable and will remain very powerful for many years (and in some cases, decades) to come. Indeed, we explicitly resist the fashionable urge to pepper Montaka's portfolio with numerous 'new themes' for reasons detailed in a piece from our most recent Montaka Monocle titled: [Why have investors become theme junkies?](#)

Take, for example, the ongoing shift in commerce to digital channels. This theme, in various forms, has been around for the last two decades. And yet, E-commerce accounts for less than 20 percent of US retail sales today; and less than 25 percent of Chinese retail sales today. Today, we continue to see significant innovation and investment in friction-reducing technologies by the likes of Facebook, Amazon, Alphabet, Tencent and Alibaba.

These businesses are creating the tools required for businesses – small and large – to create and execute effective marketing campaigns more easily. And at the same time, they are investing to make the consumer transaction experience more seamless and enjoyable. There remains enormous runway ahead and the winners are already relatively well-defined (and strangely out of favour with many investors, which is Montaka's opportunity).

Now, while the world's mega-tech businesses are driving growth in aggregate E-commerce adoption, there will be select long-term winners in particular verticals with high barriers to entry that have built very strong (and expanding) advantages. Online sports betting in the US is one such vertical and Flutter Entertainment, owner of FanDuel, is one such long-term winner. Online sports betting remains in its infancy in the US, and is expanding at extraordinarily high rates of growth. FanDuel is the undisputed leader in a market with very high barriers to entry and continues to expand its advantages. Montaka analyst, Lachie Mackay, provides an important case study on our investment thesis in Flutter Entertainment below.

These examples around the shift in commerce to digital channels illustrate an important point. Older, reliable themes often spawn valuable new iterations that can be overlooked by investors. We are currently seeing this dynamic play out to an extent in the cloud computing space. While the shift to cloud computing platforms by the world's largest corporates and governments continues to take effect, many investors see a stale theme whose day has passed. Montaka, on the other hand, continues to see enormous, unappreciated value in this theme stemming from the shift to the incorporation of machine learning models into nearly all new applications by software developers.

A valuable new iteration of a seemingly 'old' investment theme. We'll have more to say about this dynamic in a future Montaka white-paper.

Now the shift to cloud computing platforms is simply one part of the all-encompassing digital transformation journeys that are taking place across the world's corporates and governments. Again, this transformation started years ago but has drastically accelerated since the onset of the pandemic. (Our 2020 White-paper on the subject can be found [here](#)). Consider that Salesforce, the company that pioneered the 'software-as-a-service' model, just upgraded its total addressable market by another US\$40 billion (now estimated to be US\$248B by 2025) – from just six months ago. And at its Investor Day last month, company founder, Marc Benioff, guided to long-term operating profit margins 2-3x higher than current levels. Again, while the theme may not be new, it is long-term, reliable and continues to drive substantial mispricings in stocks that we believe continue to persist today.

Similarly, in the world of asset management, the 'hunt for yield' is not new. The US 10-year government bond yield has been at or below five percent for the best part of the last two decades (and at or below three percent for the last decade). What is new are the powerful investment platforms that have been built by the likes of Blackstone across different asset classes, different geographies and sectors, and for different client types. Advantages in scale, deal-flow and talent attraction result in higher AUM and earnings, which drive a flywheel to extend these advantages further. Again, a valuable new iteration of a seemingly old investment theme.

The core investment themes that underpin Montaka's portfolio are highly reliable in nature. From the digital transformation of numerous forms of human consumption, to the new digital investments being made in business and government infrastructure, to the structural growth in demand for effective healthcare, to the structural hunt for investment yield, described above, to name just a handful. **We take comfort in knowing that these themes will continue to play out, slowly but surely, over the long-term. We believe this reliability provides Montaka's investors with valuable peace of mind amidst a rapidly changing world.**

And there were no shortages of new, globally significant developments during the September quarter. From the Fed indicating it will soon begin to tighten its monetary policy, to uncertainties around US fiscal spending (and the ludicrous risk of the government failing to raise its debt-ceiling), to China Evergrande Group failing to meet its bond coupon payments, to the general election of Europe's most powerful country that will likely result in a somewhat dysfunctional and unstable German government, to the ongoing geopolitical jostling between the US, China and other important players.

Without even taking a view on how these issues resolve themselves, it is clear there are multiple sources of future equity market volatility on the horizon. With so much uncertainty, what are investors to do?

**Montaka's answer is to invest with a truly long-term perspective in the undervalued winning businesses exposed favourably to the reliable thematic tailwinds we describe above. Indeed, it is only with such a long-term perspective can one confidently look through the daily noise and retain a good chance of owning the true long-term outlier businesses.**

Through this lens, it is perhaps little surprise, therefore, that Montaka's portfolio experienced only very modest change during the quarter. In response to the recent weakness that many of China's technology leaders have experienced, we took the opportunity to add to Montaka's positions in Tencent and Alibaba. Valuations in these names are simply too low, in our view.

Consider Tencent, for example. We believe investors are failing to appreciate that nearly 40 percent of the company's value is now made of external portfolio company investments, including Meituan, JD.com, Sea, Pinduoduo, Kuaishou, Bilibili, Epic Games, Spotify, Warner Music, Afterpay – and many others.

Upon stripping these out, the 'rump' of Tencent can be acquired today at a mid-teens earnings multiple for one of China's highest-quality digital platforms businesses.

In July, Montaka added a small new position (less than one percent) to the portfolio in Moderna. Our 'variant perception' can be summarised as one of vaccine persistence – there is a reasonable probability that humans will require multiple shots of COVID-19 vaccines over time, especially if new significant variants materialise. While we acknowledge Moderna's current valuation appears rather healthy, the long-term optionality around Moderna's mRNA technology being used in other vaccines remains substantial.

Geographically, there were no major changes to the positioning of Montaka's portfolio from the prior quarter. We remain reasonably balanced across developed global markets, dominated by the US, EU, UK and Australia. Montaka continues to participate in emerging market exposure selectively, through Montaka's investments in China's Tencent, Alibaba and India's Reliance Industries, owner of Jio Platforms.

\* \* \*

Regular readers will know we like to keep investors updated with developments in Montaka's underlying business. We believe a strong, stable and effective investment manager is just as important as our stock selection and portfolio management.

Montaka's business continues to grow with the addition of several non-investment personnel over recent months. Justin Bradshaw joins us as Montaka's Operations Manager; Giles Goodwill joins us as Montaka's Private Client Manager; and Gerson Chevez joins us as Montaka's Marketing Coordinator. We welcome Justin, Giles and Gerson to the Montaka family.

Our non-investment team, led by CFO Craig Morton, is of enormous importance to Montaka. This team ensures the smooth and accurate operations of all our funds, systems, communications and processes. And they provide you and all our investors a personalised channel access to relevant information, ask questions, provide feedback and any other service required.

We take this opportunity to thank you again for your ongoing trust and partnership in Montaka's investment journey. It is our great privilege to help protect and grow your capital, right alongside our own, over the long-term. And we continue to endeavour to deliver you the best possible all-round experience as a Montaka investor.

Sincerely,



Andrew Macken



Chris Demasi

## CASE STUDY: FLUTTER ENTERTAINMENT

Many investors know the unprecedented opportunity that has emerged in US online sports betting. The sector is expected to grow from US\$1 billion in 2019 to US\$30-50 billion in revenues by 2030.

As we've noted before, two operators, FanDuel and DraftKings, have a significant head start. But after expanding to a 45% market share of US online sports betting in the second quarter of 2021, it is clearly Flutter Entertainment's FanDuel that is best positioned to dominate the market.

We believe that FanDuel is following the playbook of another one of Flutter's highly successful businesses: dominant Australian operator, Sportsbet.

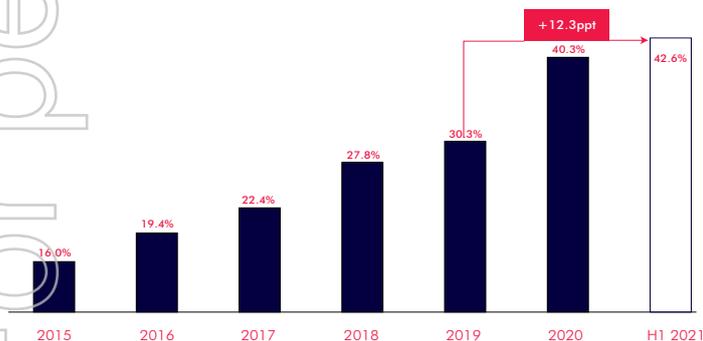
It is uncertain what the US competitive landscape will look like after years of newly regulated states and competitive customer acquisition still to come, but if Flutter can replicate Sportsbet's success with FanDuel, it will help to unlock the huge valuation upside that makes Flutter such a compelling investment today.

### THE SECRETS OF SPORTSBET'S DOMINANCE

Sportsbet commands 50% market share of Australian online sports betting. It has expanded in recent years, helped by their popular recreational brand, unmatched product quality, and a fierce customer focus that has been reinforced by data science.

As you can see in the chart below, Sportsbet has been taking more share of the total Australian sports betting market, with retail sports betting (the TAB monopoly) steadily declining for years. Consumers have been shifting to superior mobile products such as Sportsbet, a process accelerated by 2020-21 lockdowns.

Sportsbet pro form share of total sports betting market



Source: Sportsbet 2021 Investor Day

Sportsbet recently hosted an Investor Day where they outlined how they acquire and retain customers as well as the complex data systems that have enabled them to grow dramatically.

We identified three key developments that are unique to Sportsbet and highlight their dominance, and which point to FanDuel's potential success in the US.

### 1. Sportsbet's 'scale economics shared' model

Firstly, Sportsbet is successfully reinvesting its revenues to attract new customers and grow rapidly.

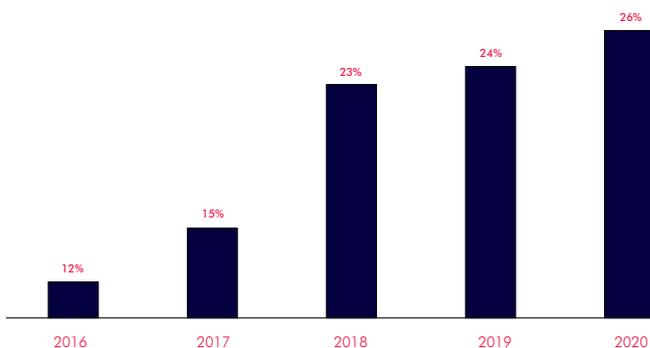
'Scale economics shared' is a term coined by famous investor Nicholas Sleep. Sleep identified retailer Costco's 'flywheel', where the company lowered prices to attract more customers, which increased volumes and customer loyalty and lowered per-unit costs, and then reinvested those gains back into customers by lowering prices again. Like a physical flywheel, repeating this cycle builds momentum that is harder to stop with each turn. Sleep later noticed the same phenomenon at Amazon. That insight, and the realisation that scale economics shared is a far stronger model on digital platforms, led him to bet big on the 'overpriced' Amazon in 2007.

Sportsbet, likewise a digital platform, has taken a leaf out of Amazon's book by relentlessly focusing on their own customer 'generosity' flywheel. They reinvest their revenue growth back into customers in the form of promotions (i.e., lower prices), increasing volumes and customer engagement, which drives further revenue growth that gets reinvested again to restart the cycle.

As a result, Sportsbet's gross gaming revenue (GGR) margin – the percentage of total bets staked that are lost; i.e., bets that Sportsbet keep as revenues – has more than doubled over the past ten years. In the first half of 2021, GGR was an unprecedented 16.1%.

As gross revenues have doubled, so too has Sportsbet's 'generosity' – the percentage of revenues earned using promotions such as boosted odds or risk-free bets and therefore financed by Sportsbet. As a result, Sportsbet's net revenue margin has remained steady.

Generosity % of GGR



Source: Sportsbet 2021 Investor Day

But that 'generosity' has allowed Sportsbet to significantly grow its customer base. Average monthly players have grown at a 21% compound annual growth rate (CAGR) since 2015. Greater engagement has meant those customers have placed more bets, growing net revenues at a 32% CAGR over the same period.

## 2. Sportsbet's customers are loyal

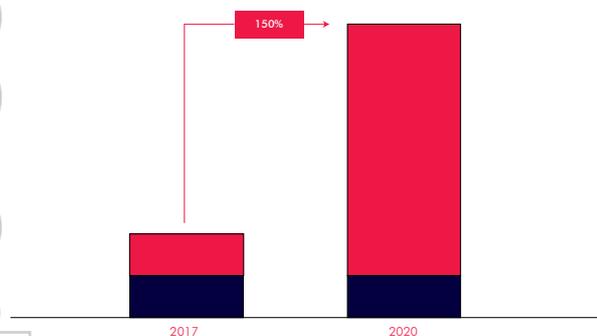
Sportsbet is also successfully keeping customers loyal to its brand.

It is notoriously difficult (read: expensive) to retain sports betting customers. A 2018 Victorian government study found the average weekly bettor had 5.5 separate betting accounts. Yet Sportsbet's market tracking survey showed the number of their customers who only bet with Sportsbet increased from 47% in 2018 to 59% in 2020, way above the 39% of their nearest competitor.

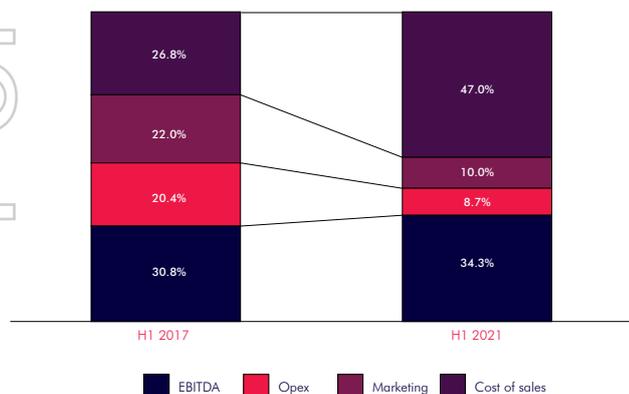
Sportsbet does three things differently:

1. Sportsbet have utilised their scale to reinvest in customers directly through personalised promotions. They have developed machine learning algorithms that offer customers personally boosted odds based on their prior betting activity. This is only possible because of Flutter's superior global risk and trading platform, used by both Sportsbet and FanDuel, which matches bets across platforms and adjusts odds in real time. Bettors shopping around for the best odds will land on Sportsbet more often, and increasingly so as algorithms learn how to efficiently promote to them.
2. Despite spending double their nearest competitor on marketing – Aussies will understand when I say their ads are unique in bringing to life their broad product range and customer focus – Sportsbet's increased scale means that as a percentage of revenue marketing spend has more than halved in the last four years.

Generosity and marketing spend (\$m)



Distribution of net revenue



Source: Sportsbet 2021 Investor Day

3. These excess revenues have been invested in Sportsbet's product and technology. Sportsbet have moved their platforms onto

Amazon Web Services (AWS) cloud servers and significant technology investments have led to best-in-class app functionality and record up-time. Meanwhile, innovations such as 'Same Game Multi' and 'Bet With Mates' have increased customer engagement and the amount of high-margin multi-bet wagers placed.

The flywheel of personalised promotions, marketing efficiency and innovative technology has formed a moat around the business that protects it from competitors. No other Australian operator can afford to invest enough in any one of these areas to catch Sportsbet. Meanwhile, Sportsbet will keep reinvesting, customers will get stickier and the flywheel will keep spinning.

## 3. Regulation entrenches incumbents

Thirdly, gambling is a natural target for increased regulation. As you can see in the 'cost of sales' bucket in the chart above, Australia has taxed betting companies increasingly as the sector matures. This has led to significant consolidation as subscale operators cannot afford to compete. Sportsbet only counts six material competitors left today of the sixteen that have been present since Flutter (then Paddy Power) first acquired a controlling stake in 2009.

Regulation is important to encourage safer gambling, fundamental to the future of sports betting as an entertainment product. Flutter is especially proactive on this front, with each division working with local regulators to ensure appropriate controls are in place. Flutter is conscious of problem gambling issues and have introduced bet limits and internal controls, using customer data to efficiently identify concerns before they can cause damage. Ironically, increasing regulatory costs further entrenches the incumbent scale operators, such as Sportsbet.

## FANDUEL: UNIQUELY POSITIONED TO REPLICATE SPORTSBET'S SUCCESS

While Sportsbet's growth is astounding and likely to continue, the most important takeaway is that FanDuel are uniquely capable of replicating this success in the US as part of the broader Flutter Group.

Fundamental to Sportsbet's flywheel of customer generosity is Flutter's global risk and trading platform, which prices odds efficiently and enables the machine-learning algorithms that optimise personalised generosity.

FanDuel utilise the same platform and can deploy any current or future innovations at other Flutter divisions seamlessly. In fact, FanDuel are already showing evidence that they are on track to replicate Sportsbet's 'scale economics shared' flywheel.

Furthermore, teams across the Flutter Group are incentivised to collaborate with one another. All senior staff have a portion of remuneration tied to Group outcomes. FanDuel's risk and trading leader is a Sportsbet veteran. Sportsbet even told investors that they work especially closely with FanDuel due to their similar platforms and the popularity of US sports in Australia. Sport-specific product innovations are a result of daily collaboration between these teams.

There are 5,000 engineers across the Flutter Group who are helping to support the FanDuel business. By contrast, DraftKings have around 1000 employees in total, not to mention questionable back-end technology. FanDuel are widely regarded to have the best product technology among US operators.

Evidently, FanDuel are fortunate to be part of Flutter as they seek to dominate the US market. While barriers to entry are low, barriers to success are far higher than many appreciate.

Sportsbet's winning flywheel model has provided a playbook FanDuel are uniquely positioned to replicate. The US market is still at a very early stage of rapid growth, and we are excited to have found what we believe is a high probability winner.

Longer-term, there are emerging markets around the world beyond the US which Flutter may use the same playbook to conquer.

Highly competitive odds for customers...

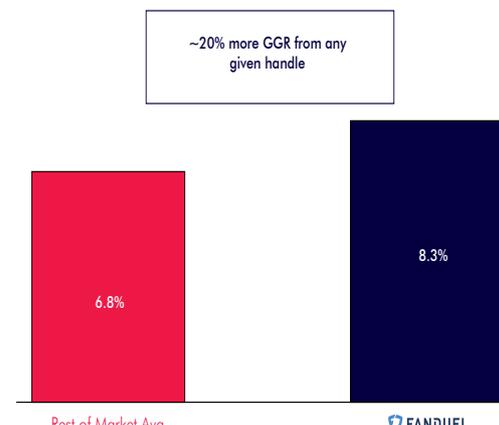
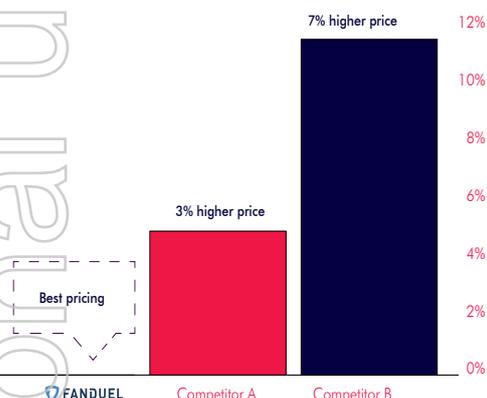
...better pricing accuracy and product mix improve trading margins..

...generating higher revenue

Stake weighted over-round vs FanDuel

Rolling 3 month average trading margin of FD Sportsbook

Online Gross Win %  
(12 months to June 2021)



Source: Flutter H1 2021 Earnings Presentation

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