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## Introducing our latest additions to the Growth Portfolio

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Although we have taken a cautionary approach to managing the Growth Portfolio in recent weeks, we are still looking for select investment opportunities that might leverage current or potentially sustained themes to come out of the COVID-19 pandemic.

Technology services have been at the centre of this emphasis, which is easy enough to understand when you consider the role technology is playing in keeping us all connected, and in many cases, still conducting business.

However, we also believe there are other key themes playing out that are conducive towards identifying attractive investments. One of these relates to the health and fitness space, whereas the other concerns technology hardware, or more specifically, semiconductor manufacturing. With this in mind, we will add positions in Peloton Interactive (PTON) and Taiwan Semiconductor Manufacturing Company (TSM) to the Growth Portfolio.

### **Peloton Interactive (PTON)**

Founded in 2012, Peloton is an exercise equipment business that listed on the NASDAQ late last year. The company is known for its stationary bicycles and treadmills, as well as virtual fitness classes that form part of a monthly subscription service where users may stream exercise lessons via the internet. These classes span from running to cycling, yoga, meditation and more.

Driving our investment thesis is the current lockdown in the United States, which has been more profound than any other economic disruption in modern history. Businesses of all scale and sizes have been impacted by lockdown measures, with gyms among those hardest-hit. The reason being, shared exercise spaces pose a heightened risk for transmission of the deadly Coronavirus.

While certain states like Georgia have given the green light to reopen gyms and fitness centres, many owners have deferred reopening such facilities altogether amid health concerns. Among those which have opened, the number of returning clientele has been modest to say the least. In other states, quite understandably, reopening gyms and fitness centres is set to be one of the last measures associated with lifting the lockdown. On this basis, we can expect gyms to predominantly remain shut for some time.

We also expect human behaviour to play a role in facilitating growth for Peloton's products and classes. There is no shortage of people that want to remain active, regardless of whether that means exercising at home. As such, Peloton's hardware and service offering is a 'complementary' solution in the current climate where there is considerable uncertainty and hesitation to leave the home for non-essential activity. Evidence of this comes courtesy of the company's record-breaking attendance numbers for just one of its recent virtual classes, where 23,000 participants took part.

Even if gym restrictions are lifted, we believe they will see a reduction in visitors. It is likely many individuals will be apprehensive for some time about returning to gyms and fitness centres, which are more conducive to transmission of a virus than many others. Furthermore, the risk remains that a second or third wave of COVID-19 could arise and result in another lockdown.

Apart from its multi-revenue generating business model, and the current societal and behavioural trends that lend themselves to prospective sales growth, there are also other catalysts for Peloton stock. One of these is scale, with the exercise equipment business now boasting more than 2 million members across the world. On this point, the company is still in the early stages of its overseas expansion, which will provide further sales upside and ultimately help diversify the company's exposure to different socio-demographic trends.

In addition, the company's premium positioning has barely deterred customers. While its bikes are selling for US\$2,245 each, and treadmills sell for US\$4,295 each, demand has soared. Such is the demand for the company's products, delivery wait times have ballooned to 7 weeks. Assuming the company can iron out this bottleneck via operational efficiencies, there is sure to be even more underlying demand that bodes well for further scale to be leveraged.

Above all that, with the bundling and integration of subscription classes providing Peloton a recurring revenue stream that facilitates high incremental margins, Peloton has created its own competitive moat of sorts. The clearest indicator of this is the company's loyal retention rates exceeding 90%, suggesting this is only just the beginning.

### **Taiwan Semiconductor Manufacturing Company (TSM)**

Not only the world's first dedicated semiconductor foundry, but today the largest one as well, Taiwan Semiconductor Manufacturing Company (TSMC) is an industry leader specialising in producing chips and processors on behalf of other companies. The dual-listed business boasts a long list of high profile technology customers on its books, a feat that has allowed it to post significant growth over the last decade and herald a new era for the company.

In its most-recent quarterly results, TSMC almost doubled its net profit to US\$3.89 billion on the back of a surge in sales for processing chips with faster capacity. The result, which exceeded market forecasts, confirmed the company's fastest growth in almost 10 years.

While TSMC has moderated its outlook for the second half of the year, it still anticipates that revenue will grow on a "mid-to-high teen" percentage basis. Any negative impact is expected to be temporary, and even then, these numbers are reflective of a downturn, which gives us confidence in the long run coming out the other side once demand for consumer electronics picks up.

Sparking this could be the deployment and adoption of 5G technology, which is set to act as a tailwind for the business, just as an increased dependence on AI applications could do likewise.

A major win for the company that will underpin medium-term sales growth is news that TSMC look set to be an integral partner with Apple to build the next generation of chips used in Mac computers. While Apple is already a customer of the company, a foray into the Mac segment could represent the next stage of a lucrative relationship.

The next-generation of Mac computers are expected to include vast improvements in speed and an increase in the sheer number of processing 'core' units used compared with existing models, as well as the iPhone and iPad. Furthermore, dislodging Intel as incumbent manufacturer would be a significant milestone for the company.

Another drawcard associated with the stock is the company's business model. As an outsourced producer, TSMC is leveraged to a diverse line of revenue regardless of which chip designer edges out the competition to feature in the latest consumer devices. Holding more than 50% market share in a rapidly expanding market, the company has a commanding position and reputation. What's more, its manufacturing expertise has come to the fore in recent times, allowing TSMC to develop the first 7nm chip last year. If the company can retain competitive advantages like this, we anticipate further growth in the company's share price over the long-term.

### **Adopting a covered call strategy**

Amid the current risk-off climate, we intend to employ covered calls as part of what is considered a relatively low risk strategy that may help generate income for the portfolio.

This involves us selling call options against the positions we've added. In turn, we collect the option premium paid to us by the option buyer, providing a guaranteed income stream. If the price of the underlying shares were to rise, and the buyer were to exercise the option we have sold them, we would be required to sell the corresponding shares at the designated strike price.

However, we anticipate near-term market volatility may potentially cap any significant advance in share prices in the short term. If this transpires as expected, and the stocks remain below their respective strike prices, this strategy would allow us to retain the shares and see our bullish outlook play out for the companies across the mid-to-long-term.

For more information please don't hesitate to get in touch

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