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THE METAVERSE A CRITICAL VIEW FROM A TECH INVESTOR

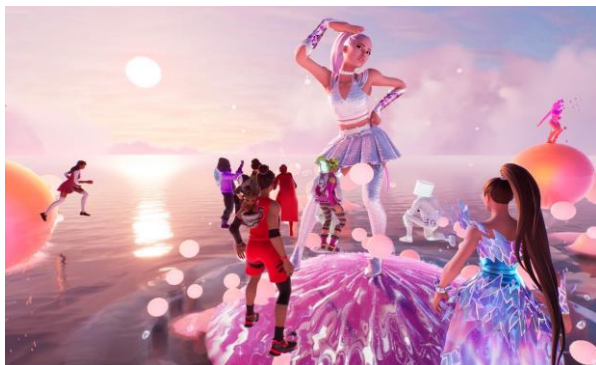
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The metaverse, the newest buzzword in town. Ever since Facebook, one of the largest companies in the world, decided to change its name to Meta and pledged to invest \$10bn a year in the metaverse for the next decade, we've seen share prices of companies, even only remotely tied to some form of metaverse, explode. Only to come down big time with the start of the new year and the selloff in technology related stocks. With Big tech companies calling this phenomenon the next evolution of the internet, is the metaverse really something new and how can investors benefit from this megatrend?

What is it and is it new?

The metaverse is nothing new, already 30 years ago Neal Stephenson mentioned the term metaverse in *Snow Crash*, a science fiction book. He describes the metaverse as a combination of virtual reality (VR), augmented reality (AR) and the internet. People can work, study, go shopping, go to concerts, and interact with each other in an immersive environment. Visionary to say the least. Moreover, the online virtual world *Second Life* is just shy of twenty years old. So, clearly it is nothing new, but then why the sudden focus? First, not only is Facebook a tech giant committed to spending billions on their metaverse, they also tend to focus where attention and eyeballs are going. They bought WhatsApp and Instagram, because they saw the youth spending time on other platforms than Facebook. For the youth of today, Facebook is something your mom and dad have. In that light, Instagram in particular was a very good acquisition in hindsight, even though the market was less a fan at the time (of the price). So, people are paying attention if Facebook is making a move. They probably saw both Fortnite and Roblox building a massive user base globally. Moreover, that (very young) user base is doing more than playing games as it serves as a social meeting point, concerts are being held (see picture below for a recent concert of Ariana Grande in Fortnite) and virtual shops like Vans world are being created. Facebook can only think of such a world with advertising dollar signs in their eyes. Add in terms like NFT (Non-fungible token) and crypto, both of which can thrive in virtual world, to the metaverse and you have a buzzword party capturing the imagination of the market.



Source: theverge.com

Imagination on the loose?

But is our imagination going too far or are we really going to a world similar like we can see in Steven Spielberg's *Ready Player One*? First of all, there is no one metaverse. There are currently many different versions and forms of metaverse. We'll come back to this later. So at least for the foreseeable future there will be different experiences. Secondly, try using a VR-headset for a few consecutive hours. You will not be the first to experience nausea. To be clear, we don't think a metaverse necessarily needs to be accessed by a virtual reality headset. One can do so via phone, tablet, PC, console etc. although that might be less immersive. Personally, we are more excited by prospects of Augmented Reality, where digital elements are projected in the real world. A headset is still needed (for now) but this can be simple eyewear. Can't wait for making phone calls Star Wars style. Latest rumors are Apple is creating a VR and AR headset combined (Mixed Reality) ... Thirdly, we're a bit skeptical we or the youth of tomorrow will do everything in a virtual world. We can see ourselves having virtual meetings and even going to concerts online from time to time. But when it comes to watching movies or Netflix, still a great portion of our time spent, we would be surprised many will want to go into a virtual world to watch Netflix with friends on a screen within a screen. *Netflix and Chill* is as far as we would take it, but then again, we might be getting too old to properly understand what drives a teenager today.

Moreover, although we can see ourselves doing virtual meetings from time to time, our real live conversations and interactions are far too important to do it all digitally. To conclude this section, we do believe there will be more and more applications that will be successful in the metaverse, and find it interesting enough to look for investment opportunities but the transition will be gradual and there are certainly limits to where society will take this (Hopefully).

So how can we invest?

While we by no means will try to be exhaustive, we will try to provide our readers with some potential interesting areas to explore. The first place we could look at are existing metaverse platforms, given a potential first mover advantage. The only real listed pureplay is Roblox, which has about 50m Daily Average Users spending billions of hours on the platform already. Nike, Disney, Gucci and many others already have branded sponsored experiences on the platform and the CEO of Roblox famously said *in the next 3-5 years all brands will have a Roblox strategy*. It would seem Facebook recently launched a similar world with *Horizon Worlds*, where you can now create your own floating legless avatar, the start of their Metaverse? Elsewhere, Fortnite is owned by private company Epic Games although Tencent has a large stake. Going more to Asia, South Korean company Naver has an existing

metaverse platform called Zepeto offering only virtual experiences but is also developing a new hybrid one called Arcverse that will combine Digital and real worlds. Staying in Asia, as one of the largest gaming companies in the world, Netease can't stay behind and will release its own user generated game creation system, like Roblox, but focused on adults (the challenge with Roblox is that a large part of its user base is less than thirteen years old).

Instead of trying to pick which metaverse platform might win, one could also consider investing in the arms dealers of the meta wars. These platforms need content, without content people will get very bored very quickly. It is in this context that one could look at the largest acquisition in Microsoft history, game developer Activision for US\$68.7bn. Gaming is still one of the most obvious beneficiaries of these virtual worlds and also one of the most attractive to users. From a Microsoft perspective we think Activision is a great acquisition, adding one of the best gaming IP (Warcraft, Starcraft, Call of Duty, etc) in the world to their portfolio. Whether the acquisition will be allowed to go through that easily is another question. Given it is a large distributor (Xbox) buying a large content developer and given it is a large cap tech company doing a large acquisition (although Microsoft is so big that this is not really a big deal for them), let's see if US regulators are all bark and no bite. It certainly puts in the spotlight other game developers like EA, Take Two and Ubisoft. One also needs to create these gaming experiences, potentially using the engine of Unity Software... Another potential interesting area is music, brought back from the dead by streaming companies like Spotify. It is expected Music will increasingly see revenues coming from games and the metaverse.

Outside of software/IP arms dealers, one could look at the hardware side of things. Companies providing components going it VR headset for example. From displays to lenses to sensors, although we personally tend to avoid many of the hardware component makers (risk of commoditization among others). One exception might be Nvidia, given their massive lead and opportunity in leading edge silicon. We also like Nvidia's *Omniverse*, a powerful digital simulation platform that was created to enable users to simulate "digital twins" of real-world objects/structures. Again, we are not trying to be exhaustive here as one could think of many semiconductor, networking, storage and infrastructure companies benefitting from increased datacenter investments to support these metaverse platforms as well.

And what about ESG considerations?

Increasingly we must face the inevitable questions on ESG considerations, probably for the better. Facebook/Meta has not been an ESG darling for the investment community, to say the least. From targeting products to minors, despite its own research showing that some teenage girls have committed suicide as a result, to spreading misinformation and influencing election outcomes, the allegations towards the company are too numerous to mention them all. In comes the metaverse and a recent article by the Financial Times which looked at hundreds of applications to the US Patent and Trademark office to find out how exactly Facebook might profit from the metaverse. It should come as no surprise the company would use hyper-targeted advertising and sponsored content. But using users' biometric data like eye movements to power these might be a tad more controversial. Moreover, Meta already incorporated a safe zone button as users have been groped in a virtual world. To be clear, the latter is not just a problem for Meta, but it demonstrates that even in a virtual world, user safety is a concern. Although we as well need more work to be done on the subject, we could adopt a similar approach as we do for gaming. We consider gaming as having a neutral impact, but individual companies can pivot towards positive impact if they incorporate proper rules and incorporate effective policies, e.g. surrounding minor protection. Or when the company produces educational games as well they score positive points. Similarly, we can see both positive and negative effects from the metaverse and hence, we could consider it neutral accompanied but a proper ESG analysis on the individual company level.

To conclude

Many companies stand to benefit from all these investments in the metaverse. But given we don't really see a path towards one true metaverse, we believe many different ones will compete and might at the same time limit the true potential of it. We also believe there are limits to what we will do in this alternate reality. Yours truly is not ready to give up a real life after work beer with my colleagues. Although we see many opportunities ranging from advertising to shopping to music consumption and gaming, we are too old to subscribe to this view that all industries will get disrupted by this all-encompassing metaverse. Close follow up and careful stock picking, looking at fundamentals and ESG considerations, are warranted.

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