

FCL*Capital*

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To own is something from the past

Once upon a time, hard as it is to believe, owning a car and a house were the ticket to adulthood and the way to establish oneself in the middle-class. Since the dawn of mankind, the economic ladder was mostly defined by what you own and what you did not. In ancient Europe, you were part of the elite as long as you owned land; in 20th century America, you were part of the American dream as long as you had your mortgage and your car in the garage.

We dedicate this letter to the sharing economy and our investment in the one we think is truly the first sharing economy company: Regus

To some degree, the sharing economy has always existed: think of a Gym Club, Hotels or commercial airplanes. In theory we could (and some people do) own their own treadmill, own homes in multiple cities they frequently travel to or only fly in private airplanes. Over time people realized that a lot more people could have access to those things if the assets were shared, that is, since the asset is only used by any single user for a small fraction of the time - 3% of the time in case of a car, even less in the case of a treadmill. It is much cheaper and more efficient to fractionalize the ownership being member of a Gym club, a client of a hotel or Airline, and so forth.

Second, while we will make a strong case in this letter for the future of the sharing economy, we should not exaggerate our point. Home ownership continues to be a dream for many families, and even cars are not going away any time soon.

Nevertheless, we think for the first time in human history the stars are aligned to make the sharing economy explode in the next couple of decades in a way people have not yet fully grasped.

Why will the future be so different from the past? To answer that question we have to think about the advantages of owning something instead of leasing it or renting it in the first place. The biggest of them all is surely the power to use the asset any time we want the way we want it. For the first time in history, technology and the internet gradually were able, if not to kill this advantage, at least to severely wound it.

Think of Uber for example. As we stated above, an average driver only uses his own car 3% of the time. For 97% of the minutes in an average day your car just sits there, waiting to be used. Still, hundreds of millions of people around the globe are car owners.

The reason is that it would be a painful hassle to need your car sometime and not to be able to instantly use it. Uber, for the first time ever, is largely making this worry disappear: it gave millions of people an instant ability to summon up a luxury car with a driver and for it to be available in minutes, almost anywhere on the globe.

This does not mean that car ownership will disappear soon, but it already means that millions of drivers around the world, especially in urban centers, are starting to question the logic and economics of owning a car.



Uber

- Startup based in San Francisco that operates the Uber app, that lets users submit a trip request to drivers using their own cars.



TaskRabbit

- An online and mobile marketplace that matches freelance labor with local demand, allowing consumers to find immediate help with everyday tasks.



AirBnB

- A website for people to find, list and rent their properties and rooms, with more than 1.5 million listings worldwide at the time of this writing.



HomeAway

HomeAway

- A vacation rental marketplace with more than 1,000,000 vacation rental listings in 190 countries



Regus

- A multinational corporation that provides flexible, on demand workplaces.

It takes time for people to realize how the dynamics of many situations have changed and most importantly, for mentalities to change. Traditionally, "renting" an asset was viewed as a step in the ladder, a pathway to someday being able to buy it. A second-class user.

Now, rich people and even billionaires are waking up to the pleasures of the sharing economy. Some AirBnB listings are clearly made for the 1%, as the many listings for posh Swiss ski chalets, properties in St. Barths or mansions in the Hamptons in the thousands of dollars' attest (although still vastly more affordable

than if someone was forced to buy those assets). Likewise, the New York Times has recently run a piece¹ about internet companies specialized in rentals of private islands and yachts that could count among its client's names like Bill Gates.

Why does people like Gates are switching to sharing assets when they could clearly be buying them? Part of the answer is the worldwide trend from a "buyer of things mentality" that dominated the 20th century to an "acquirer of experiences" mentality that is starting to dominate this one.

People around the globe are increasingly realizing that time is a precious asset. They just realize that once the internet has made possible for them to use what they want when they want (as long, obviously, as their credit card allows it), be it a black car, a private island, an airplane or a yacht, why to face the hassle and headaches of administering staff, paying electric bills and replacing light bulbs?

One of the reasons each year of our lives passes faster as we get older is because our time is measured not in days but experiences. Since as we get older we tend to live fewer novel experiences, time tends to pass faster. Humanity is increasingly focusing on experiences versus possessions that stand still and there is good scientific research to back them up.

If technology is increasingly making all of this possible, what are the limits of the sharing economy?

¹ [Link to the New York Times piece](#)

The more we think about it, the more we can see how endless the possibilities are. We usually call “utilities”, everything that is indispensable but easily available from external sources, like energy and water. Will technology make every asset on the planet a utility?

Will no one be interested in owning a car since we can use Uber instantly everywhere, or to own a house since in our street there will be every night houses similar to ours? Will the company headquarter be outdated once Regus fulfills its plan to allow us to work anywhere anytime with more productivity? We obviously would not go that far, but we would make the case that we are going at least a little bit in this direction.

Funny as it is to note, Karl Marx once stated that people are divided between the ones who owned the means of production and the people who do not. What would he say about a future where people are increasingly uninterested in owning anything?

In any case, the same technology that allows us to sum up an Uber car or to rent a villa in the Bahamas using AirBnB is gradually changing people’s notions and habits of work.

A well-documented fact on the media is the rise of the so called “gig economy”, that is, an army of self-employed or quasi-self-employed free lancers that work by themselves, some employed and doing tasks daily to people they have never met.

Increasingly, people are able to compartmentalize tasks, outsource, delegate, and combined with an increasing desire to work in different hours and rhythms due to different circumstances, geographies, desires and talents, the result is that according to most

estimates, more than one billion people will actively work from home until the end of this decade.

Not only this, but even inside companies themselves, there is an increasing popularity of Results Only Programs among big companies, used as a solution for work and life balance, fundamental for retention of talents.

Companies are starting to allow employees to work from anywhere they please as long as they complete their tasks, due to the fact that thanks to an increasingly knowledge intensive economy, an increasing percentage of workers have to work remotely and complete tasks away from the company's main headquarters. Being on the move, visiting clients, attending conferences, doing remote work and usually trying to find a place with decent Wi-Fi to be able to perform these tasks.

Besides technology, there's also a desire to cut costs, reduce burnout and stress and reduce the commuter's pain in an increasingly chaotic traffic. Not to mention that we all now have devices in our hands that are vastly more powerful than supercomputers of 20 years ago used to be. This makes the notion that employees who could easily communicate, innovate and collaborate online having to lose so much time to physically be in a single place somewhat irrational, archaic and better suited for a time when work was a material and not a creative thing.

In the 21st century, the possibilities to "own your own time" and to "work on your own hours" are important for people who have their knowledge and creativity as their assets.

With the advent of e-mail, Slack, instant messaging and videoconference... is a central office even necessary for many activities? At least, is going there every single working day and facing traffic, not to mention stratospherically rental costs for the companies involved necessary?

Meanwhile, technology is in subtle ways making working habits more complicated: people increasingly answer important work emails at midnight while, according to a recent Verge post entitled "Working from work is a thing of the past", spend their office afternoons watching Kanye West² or checking social media.

No wonder thousands of Starbucks around the world are filled with people with their laptops while hundreds of million work from their homes. Some people even claim that they escape from office when they have to do "important work".

As anyone who has ever tried these methods might attest, they are not optimal. Starbucks tends to be noisy places, while working from home can be hell, with children's demands, pleas for attention and knocks on the door.

According to CBRE's latest Shared-Office Report, the co-working trend is posed to experience a compounded 21% yearly growth in the next five years. According to the same report, "flexibility is key for the millennial generation, which has a different set of wants and needs than previous ones"³, who were more interested in security and appearances.

² [Link to The Verge piece](#)

³ [Link to the Seeking Alpha piece](#)

Regus is in a unique position to thrive in this next century, when people will have supercomputers in their hands and ability to work from anywhere, always on the move, valuing speed and flexibility.

Regus was founded in 1989 by a British entrepreneur called Mark Dixon, that realized on a trip to Brussels that businesspeople had no option to work while travelling anywhere apart from their hotel. He identified a need for office space that was maintained, staffed, and available for companies to use on a flexible basis.

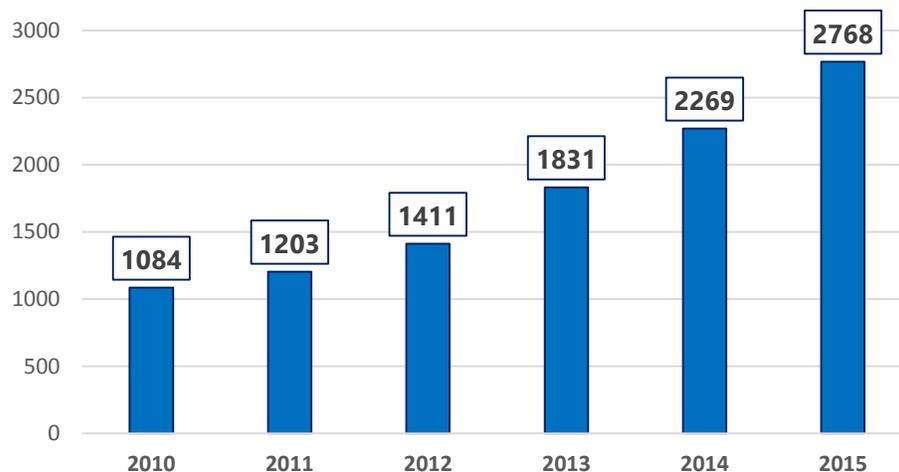
The initial idea, besides conquering business travelers, was to increase office asset efficiency: the same way a car owner does not use his car the whole time, thousands of offices around the globe are not being fully utilized. Some are partially empty; some could be refurbished so that every square inch could be put to full potential.

To do that he created the flexible office where multiple companies would share the same space, with the same secretary, coffee machine and printer. In our opinion, an insight that is great enough for us to crown it, apart from hotels, gyms and airlines, the first sharing economy company, long before the rise of the internet.

More importantly, the concept works. FCL Capital was run for a year from a Regus office in Madison Avenue in Midtown Manhattan while this manager was living in the city.

Our opinion about the company is the same as the opinion of thousands of other clients: it allows far greater flexibility and reliability, in the sense that a small team only has to focus on business and leave operational office details, activities that are non-core per excellence, to someone else.

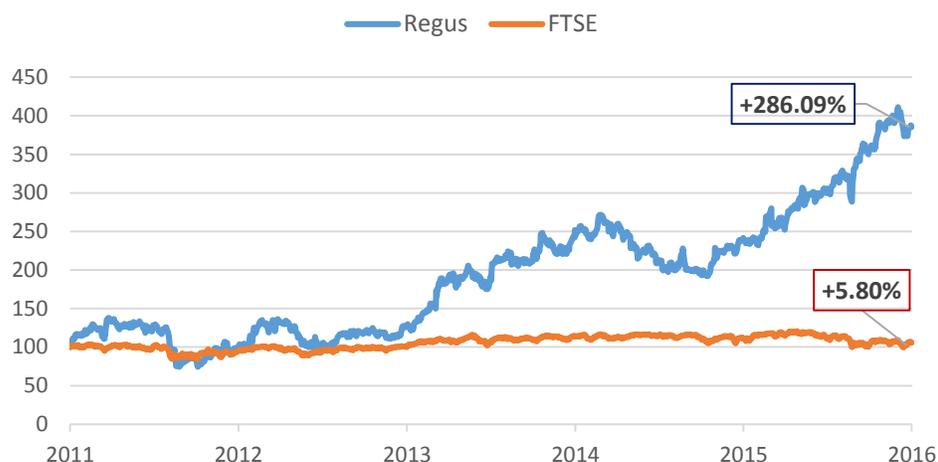
Amount of Regus Business Centers



The amazing fact is that even after this one-year experience, it took our team years to gather more information about the company to finally realize the potential of this opportunity and build a position as we did in the last few months. As it happens in love, opportunities frequently are in front of us all the time while we refuse to see them.

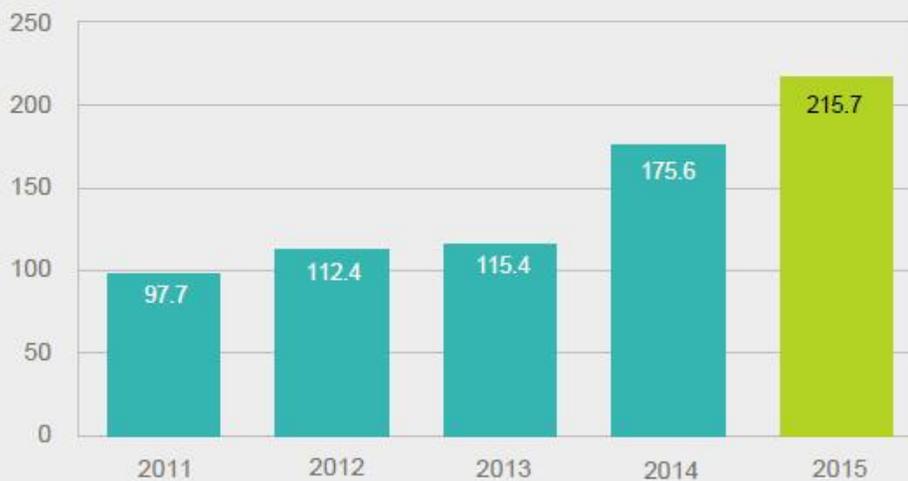
Since Regus is a fast growing company, one of the most important indicators about its health in our opinion is the net cash its operations are generating before what the company calls "expansion CAPEX", that is, the CAPEX used for expansion, besides the one used to compensate for normal business depreciation.

Regus vs FTSE, Performance in the last 5 years



According to our calculations, Regus currently trades at around 13.5 times its free cash flow pre-expansion CAPEX on an enterprise value basis, or 12.8 times on a market cap basis. We find this numbers very cheap for an excellent company, which is a leader in a fast growing industry with a clear investment proposition.

Underlying cash flow before net growth capital expenditure (£m)



In the past, we have publicly expressed our pessimism about some valuations in which private tech companies in American markets are changing hands, which we judge excessive⁴. Our investment in Regus is not a way to arbitrate public and private differences in valuation but it is hard for us not to mention that WeWork, a youthful tech workplaces company based in New York City has an amazing discrepancy in valuation compared to Regus. Let's see the basic numbers:

WeWork as of December 2015 had 54 co-working locations, mostly in the USA, London and Israel. Regus, a pioneer in the industry, has more than 2700 centers. Since WeWork is a private company, we do not completely know its numbers, although we would love to, but it is widely thought that the company is not yet profitable while Regus is a massive cash generator.

Regus vs WeWork comparison		
	Regus	WeWork
Number of Business Centers	2700	54
Positive Cash Generation	Yes	No
Value attributed by market	\$4 billion	\$10 billion

Their concepts are slightly different, with WeWork more focused in tech professionals and giving more emphasis on a "membership atmosphere" with perks such as premium coffee and free beer on tap. On the other hand, Regus has developed a similar concept, called Spaces more focused in attracting this segment of young, hippie and tech types and even this concept alone, which is a very tiny part of Regus, will end 2016 with around the same number of business centers that WEWORK has now.

⁴ [Link to Twitter tweet](#)

Nevertheless, in private markets, that is, in transactions made by venture capital companies when purchasing interests in WeWork, the company was valued at \$ 10 billion, while Regus, with 70 times more business centers and profitable, is current valued at less than \$ 4 billion.

You can scratch your head about this information as much as we did for the past 6 months. There are no reasonable explanations. Maybe the WeWork investors were not aware of Regus. Maybe they just think it is a completely different company.

Certainly, one set of investors is very wrong about their numbers, either the WeWork believers who are paying ridiculously high prices for their startup, or, even more likely in our opinion, the Regus public shareholders who are dramatically underestimating this fantastic company with tremendous potential. Which one is the truth? Only time will tell.

The consequences of this competitive dynamic could be drastic because in the sharing economy (and as we argued in this letter, Regus is a sharing economy company) there's is a disproportionate reward for the leader, in a dynamic that most technology investors usually call "a winner takes all market".

The concept is quite intuitive: suppose you want to sell your old comic book collection online. Chances are extraordinary that you will choose EBay to do this. Not because it is, necessarily, the best website to sell used goods, but simply because it is the most used one.

Since most comic collectors, and indeed most potential buyers of almost any used good, go to EBay to find bargains, knowing that most sellers list their products there and therefore the website is the place where buyers and sellers easily find each other. It becomes a self-fulfilling prophecy. Even if EBay was not the best website in this niche, it quickly became so. Buyers know this is where sellers are and vice versa. Once this dynamic is established, it becomes very hard to break. It becomes a sustainable competitive advantage and a barrier for new competitors to entry in this market.

The same dynamic can be seen in many sharing companies and internet business:

- Facebook for social media - It is where our friends already are, why should we post status updates anywhere else?
- Online dating - we have an upcoming letter about Match group coming, but spoiler alert, we are long Match and part of the reason is we think the markets are underestimating the network effects of online dating);
- Rentals - AirBnB has a huge selection because they have millions of customers and thousands of hosts) ;
- Car sharing - Chris Sacca, an early Uber investor recently gave an interview to Bloomberg West and stated "I think Uber can be worth north of \$ 150 billion dollars once it goes public and I think Lyft won't survive because this, like many internet businesses is a winner takes all market.

Many investors have not yet realized, but to some extent, flexible offices are also a winner takes all market.

As work becomes increasingly detached from the main office and corporations experiment with new structures, the leader in this field will be able to accommodate this reality and provide solutions in unparalleled ways. Verizon for example, a huge US telecom company, recently decided to transfer thousands of its employees that worked from hundreds of small branches across the country to Regus offices.

Since the company already has around 800 flexible offices in North America, it was able to accommodate Verizon demands while Verizon was able to halve its office and administrative costs related to these employees.⁵

Once we become used to working on the go, through Regus express stations in airports and train stations and once companies start to integrate flexible office models into their business plans, we think the rewards will go largely to the most established player. In the process Regus could increasingly become an essential ingredient to the way we work in the next century.

⁵ Read page 7 of [this Regus presentation](#) for more details about the Verizon deal.

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