

# FCL*Capital*

April | 2017

Every single day we pick up our favorite newspaper and read about the previous day stories. Those events shaped the planet in the previous 24 hours. At this house, we do love to read and spend most of our working hours not meeting clients or even visiting companies, but reading and studying - we are really in our environment while living in the silence of reports, research papers, news articles and balance sheets.

Like everyone else, we read lots of newspapers. As Nassim Taleb has noted in one of his books, in the vast majority of days, certainly in more than 99% of occurrences, those daily news are just worthless noise. If we take a random daily newspaper from 6 months ago, or 25 years ago, it is almost funny that people decided to give attention to such meaningless and unimportant events. Couldn't they realize that those events that looked so fresh and so important would very soon be forgotten and dismissed?

Sure, a few specific days would be different. Everyone knows that newspapers from days like September 12th, 2001 or November 10th, 1989 really did report about history being made in their respective previous days. Life would never be as it was before. But those days are surely exceptions among all the daily meaningless noise.

But things would change if we change our perspective. If we understand every single day as another building block - another brick in the wall of history unfolding. Think about a single piece of newspaper that would have the job of reporting the past 10 years? Which stories would make the front page? The 2008 financial crisis maybe? The rise of populism across the rich world? Brexit? Now, how about a newspaper with the job of reporting the past 30 years? How about having to describe, for the very first time to someone who just woke from a 30 year sleep what the September 11th attacks meant? Or the fall of the Berlin wall and the end of communism? Or, in some surprising news, China, that overlooked old communist dictatorship with lower per capita income in 1987 than almost any country in the world now was not only the world's most important trading nation, the most important consumer of commodities, the world's largest economy on purchase parity terms and on its way to become the largest economy even in nominal dollars in a few more years.

At FCL we gave some thought about this story when we launched our new Opportunities fund. The fund was constructed to provide the opportunity for Brazilian wealthy investors to access global investment opportunities. But at the same time, to really stand out and offer value, we had to sit and think: what is our edge? What is the competitive advantage that a small house based in Rio could offer that the Blackrocks and David Einhorn's of the world can't? And the answer lies in our perspective and in our timeframe.

We operate trying to read, or foresee, what the newspaper telling the story of the next 50 years will look like. And so far, we came across two major trends that we think, will be on the front page of this hypothetical newspaper:

1. Global convergence - The rise of emerging markets in general and China in particular, and
2. The technology revolution that provides opportunities and threats in overlooked places.

Let's talk about each of them.

First, what we mean by global convergence is that, in a world where knowledge and best practices flow everywhere faster than ever, (thanks to the second major trend), the difference in governance, productivity and dynamism between rich countries and emerging markets will not disappear but will probably continue to fall, as it has been falling for the past few decades.

Taken together with the fact that emerging markets are less efficient and demand more ``on the ground`` knowledge than developed ones, our conclusion is that most billion dollar opportunities in the next few decades in the public and private investment spheres won't be in the US and Europe as it has been the case in the 20th century, but in the three larger emerging markets - China, India and Brazil - that can combine the scale and

size of big populations with some if not all of the sophistication and governance of developed markets.

Note, however, the Opportunities fund invests not only in those three markets but also, and even more heavily in the US and Europe. More than 50% of our assets right now consists of shares in companies located in G7 countries plus Switzerland. How does this make sense?

The answer is very simple. We look for opportunities that were created by the vision of global convergence. Not necessarily for companies located in emerging markets. Take Match.com for instance. One of the tech leaders of the 21st century, a company created and run from its headquarters in Dallas, Texas with all the governance and previsibility of the world's most sophisticated financial market. At the same time, Brazilian and Indian young adults are signing up for Tinder at unprecedented rates. Soon, we believe, Match's international revenues will surpass for the first time its American revenues. And how could we foresee this trend when many New York based analysts were skeptical when we first published our thesis in Sumzero back in early 2016? The answer is simple; we just had to walk around the street of Rio de Janeiro to see it happening. In this sense, maybe we had a better perspective, a better observation point and, yes, a competitive edge compared to someone in London or New York.

## Chart 1

### Match.com: Global Headquarters - Dallas, Texas, USA.

#### Revenue

<i>(Dollars in thousands)</i>	Q1 2017	Q1 2016	Change
Direct Revenue:			
North America	\$ 177,362	\$ 164,382	8%
International	110,390	84,646	30%
Total Direct Revenue	287,752	249,028	16%
Indirect Revenue	11,012	11,373	(3)%
Total Revenue	\$ 298,764	\$ 260,401	15%

We look for the global convergence stories that are not yet ‘in the price’. We found another one in Pandora, a retailer made for the Instagram generation that, despite being a Danish company (and fortunately being located in a triple A country) has been having success in winning over Chinese consumers in their growing taste for individuality and self discovery. Or Dufry, a swiss duty free shop retailer that has 50% of its revenues based in emerging markets. Or IWG, as well as all of the major positions in our portfolio. In fact the one thing we love the most is a company based in a low growth and very stable economy (with good governance and low multiples because of its home country) but at the same time having growing exposure to the three largest emerging markets. This is literally having the best of both worlds.

Chart 2

Pandora: Global Headquarters - Denmark

## REGIONAL REVENUE SHARE

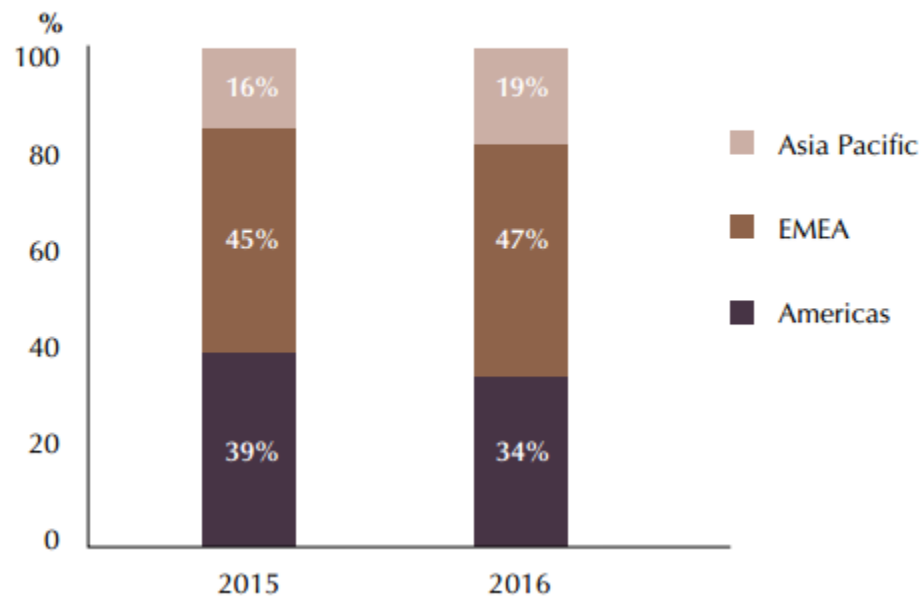


Chart 3

IWG: Global Headquarters: London, UK/Switzerland

£m	Revenue		Contribution		Mature gross margin (%)	
	2016	2015	2016	2015	2016	2015
Americas	826.2	747.8	188.0	181.9	22.8%	24.3%
EMEA	406.9	372.7	104.1	91.8	25.6%	24.6%
Asia Pacific	293.2	265.5	72.9	66.2	24.9%	24.9%
UK	358.5	361.2	83.9	84.3	23.4%	23.3%
Other	6.8	2.9	6.8	1.0		
<b>Total</b>	<b>1,891.6</b>	<b>1,750.1</b>	<b>455.7</b>	<b>425.2</b>	<b>24.1%</b>	<b>24.3%</b>

## Chart 4

Dufry: global headquarters: Basel, Switzerland

Dufry - Net Sales by Division	
North America	21%
Latin America	20%
Southern Europe and Africa	22%
UK, Central and Eastern Europe	27%
Asia, Middle East and Australia	10%

As for the second major trend, once again we like to take advantage of our unique positioning - no matter where you are in the world there is something unique about every one after all - and we do not like paying exorbitant prices to bet on who the big winners in the technology race will be. In other words, we don't spend too much time trying to find out who the next Ubers or Facebooks are. Instead, we see the tech revolution as a way to:

1. Try to avoid the companies that may get harmed and will have its moats diminished while at the same time, on the contrary, actively look for companies that are being harmed but whose share prices have fallen so much because they fell out of fashion that it provides an amazing investment opportunities , or



2. Look for Companies that even not necessarily being seen as “tech” companies can enjoy the rewards of the tech revolution in surprising ways.

For a company in our portfolio that is in the first example we would list Gannett. We see Gannett, which was the theme of our February 2017 letter as a consumer company that is selling for ridiculous prices just because people perceive it as having no future.

As for an example of consumer companies that are riding the wave of the global technological future we would enlist both Match (a consumer company the more you stop to think about it) and Pandora (a provider of perfect Instagram pictures disguised as a jewelry store).

### ***Gannett: Global headquarters - Virginia, US***

- *Total digital revenue: \$ 234.7 million (30.7% of total revenues).*
- *Digital only newspaper subscribers: +250.000 (+72.6% year over year).*

In all those cases, a few common themes will reemerge in the portfolio of FCL Opportunities in the next few years:

1. Companies that can take advantage of global convergence and globalization, even if ( and maybe preferably if ) they are located in low growth, stable developed markets.
2. Companies capable of riding the global tech revolution, preferably not being huge bets on how a particular technology will play out, but being companies that consumers will turn on to and with moats that will likely widen in the future.
3. Consumer companies because every truly great company ever created was, in essence even if not formally, a consumer company (For us, Match and Gannett are definitely consumer companies in this larger sense).

So coming back to what we said would be the theme of this letter, what is FCL Opportunities mission?

To find out the best we can about the newspaper of the next 50 years, that, we think, will bring the twin stories of global convergence and tech revolution. To find out who the winners of those two stories will be and be able to build position in some of those winners without paying too much for it.

And how do we plan on doing it? By leveraging our unique position if being at an emerging market while being able to look abroad and search the world.

Where do we think we will find those hidden gems? Mostly in the unforeseen places: developed companies that have the best of both worlds (rich world governance and stability along with emerging markets growth) or consumer companies that have the best of both worlds (traditional companies multiples, along with a bright future provided by the tech revolution).

It is a lot of work ahead and the first few months have certainly been good to give us some confidence: our fund is up since inception earlier this year. So let's start looking at the world, and let's start writing this futuristic newspaper story.

FCL Team

## Sobre a FCL Capital

A FCL Capital é uma gestora de recursos sediada no Rio de Janeiro, cujo objetivo é maximizar o retorno de seus investidores. A FCL tem como nicho principal, mas não exclusivo, investimentos em empresas abertas, listadas em bolsa de valores (posições compradas e vendidas nos mercados acionários). Para saber mais sobre nosso trabalho, entre em contato conosco ou acesse nosso website: [www.fclcapital.com](http://www.fclcapital.com).

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