

# FCL*Capital*

January 2019

## The winners

“Invert, always invert!” a wise man that answers by the name of Charlie Munger says. In other words, if you want to be a tennis champion, maybe it would be a good idea to give some thought about what previous tennis champions did and how they lived their lives. Or if you want to be a president. Or if you want to be a billionaire.

This letter is about one of the philosophical and intellectual fields of study inside FCL Capital. It is about a list we permanently and zealously track: the best performing stocks of the past 10 years and how they got there. And most importantly, what replicable characteristics can be spotted early on so we can try to identify a few more like them for the future?

One of our favorite internal screens we use for market monitoring shows us all global stocks in our investable universe (located in the markets we invest in and above minimum liquidity and continuity thresholds) that have delivered a compounded annual return over 25% yearly over the past 10 years. That is almost like multiplying their value 10 times in a decade.

All in all, among the roughly 50,000 global stocks that trade on international exchanges, our current screening of the 10 year winners show that 562 different securities delivered their investors a compounded return above 25% on average. Roughly one in 100.

One interesting finding: since we are tracking this group for a while, it is telling, as always, how the starting point alters the subsequent decade returns: usually our screening shows something between 200 and 300 names, but since 10 years ago global markets were in the depth of the financial crash and therefore global assets were trading at unusually depressed prices, we now find this unusually high number of outstanding subsequent performers.

In other words, like always, buy low, sell high.

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Looking now at the current class of winners in our screening, this could look like a very disparate group.

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Equity Screen - Universe: 10 ye - Actions - Export - Settings - Watchlist Analytics

Screen Name 10 year total returns

Refine By <Countries, Sectors, etc.> Group By Securities Show Hi/Lo As of 02/04/2019

Overview Returns Valuation Estimates Actuals Credit Technicals Custom Results

Add Column 92 Fields

Group By None 94 Stats... 562 Securities

Ticker	Short Name	Total Return: 10 (I)	Sls 3Yr Avg	Net Sales -5	Net Sales -5	Market Cap: Y	Market P/EBITDA: 10	P/EBIT: 10	P/S: 10	ST12M EBITC	Equity Trade Cap: Y	Market Cap: Y		
Median		30.00	11.95	13.16	11.41	705.3	4.15B	7.34	12.99	1.25	2.61	19.60	16.63	705.3
101) 2382	HK SUNNY OPTICAL	66.83	38.87	--	33.87	384.6	10.76	8.60	17.74	1.86	3.0	16.98	29.97	384.6
102) JAZZ	US JAZZ PHARMACE...	63.19	11.35	--	15.12	361.9	7.74B	--	9.77	3.11	4.1	42.87	76.77	361.9
103) ATSG	US AIR TRANSPORT...	62.01	22.71	0.01%	7.78%	261.8	1.40B	2.19	4.58	0.21	1.4	24.72	8.52M	261.8
104) SNBR	US SLEEP NUMBER ...	60.71	7.71%	18.94	9.48%	318.8	1.17B	4.84	9.66	0.42	0.8	10.61	16.19	318.8
105) NXST	US NEXSTAR MEDIA...	59.52	61.84	--	40.68	259.7	3.83B	3.07	4.39	0.97	1.4	32.03	27.74	259.7
106) MGPI	US MGP INGREDIEN...	58.55	3.62%	11.40	3.46%	278.7	1.20B	6.70	21.34	0.75	3.2	15.60	10.75	278.7
107) 2313	HK SHENZHOU INTL...	57.32	17.59	23.94	13.93	557.0	18.39	5.83	23.43	1.11	6.5	28.08	14.89	557.0
108) NFLX	US NETFLIX INC	52.10	32.58	38.04	28.93	1.76B	148.3	12.34	90.15	1.34	9.6	10.69	3.36B	1.76B
109) BEST	SP BEST WORLD IN...	51.86	47.52	54.61	58.38	129.0	1.10B	9.24	19.76	1.82	6.8	32.61	5.79M	129.0
110) EIM	IN EICHER MOTORS	51.51	20.22	--	5.94%	175.0	7.48B	5.50	19.52	0.31	6.1	31.47	47.43	175.0
111) HCM	LN HUTCHISON CHI...	50.76	45.65	--	42.24	140.6	2.97B	--	--	2.16	13.	-21.0	485.8	140.6
112) NEM	GR NEMETSCHEK SE	50.50	22.03	6.73%	--	302.7	5.11B	6.18	33.59	1.42	8.9	27.65	12.94	302.7
113) PAG	IN PAGE INDUSTRI...	50.09	18.48	31.13	23.87	116.7	3.74B	12.86	49.93	2.44	10.	21.47	10.37	116.7
114) 7747	JP ASAHI INTECC CO	50.07	12.44	16.31	17.22	105.8	5.69B	5.79	37.33	0.96	12.	33.24	24.75	105.8
115) TPM	AU TPG TELECOM LT...	49.89	30.81	71.95	27.60	128.8	4.69B	1.77	7.73	0.22	2.6	33.71	4.27M	128.8
116) 241	HK ALIBABA HEALTH	49.10	414.7	115.3	227.6	248.4	10.73	--	--	8.04	18.	-5.50	1.27M	248.4

Australia 61 2 9777 8600 Brazil 55 11 2395 8000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 South Africa 27 21 212 318 2000 United States 1 212 318 2000 United Kingdom 44 20 7330 7500

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We can see some very well-known companies, like Amazon, Apple and Netflix, but also some completely obscure ones, like Corticeria Amorim, a Portuguese company that happens to be the world's leading cork producer, and Sberbank, Russia's largest retail lender.

Among Brazilian companies, only eight make the cut, with Raia Drogasil and construction company EZ Tec in the top two places, alongside names like Localiza and Odontoprev.

What unites those companies? Not a lot of things, according to many market analysts.

Stock investors, as we know, tend to be grouped in two major camps: value investors, the ones that try to find “underpriced” and “underappreciated” assets, and growth investors, the ones that don’t mind paying high multiples as long as they belong to the right companies, the winners of tomorrow, that have its sales growing significantly.

We will argue in this letter that both camps have something going for them: obviously among the winners there are companies that were trading at high multiples 10 years ago that experienced very fast growth that was enough to put them among the winners regardless of valuation.

At the same time, there are companies in this groups that didn’t experience super fast growth (it was something slower but consistent) but their very low entry multiples, combined with moderate, consistent growth, also put them in this group.

Those are the extremes and obviously there are companies in between the spectrum: higher multiples, higher growth. The order of factors didn’t change the end equation.

To sum it up so far, to be a best performing stock for a decade a company had to either produce:

- a. Very high and consistent growth, or
- b. Be traded 10 years ago at very cheap valuation and still deliver consistency, or
- c. Some combination of the two above with more or less emphasis on each

And what is the glue that brings it all together?

As we will see it is the price sales ratio, a little used financial metric that calculated market capitalization divided by company's revenue.

Let's dig in:

## 1. The fast growers

Netflix:

In January 2009 Netflix had just recorded prior twelve month sales of 1.3 billion dollars and had a market capitalization of 1.8 billion dollars. Simple math tells us that this gave Netflix back in early 2009, exactly 10 years ago, a price to sales ratio (market capitalization divided by yearly revenues) of 1.34 times.

We know, with the benefit of hindsight that Netflix turned out to be one of the best performing stocks of the past decade. It's annual return on

average was an unbelievable 52% per year. Stated in other terms anyone who invested USD 1000 in Netflix 10 years ago and forgot about it, would turn out to have almost USD 66 thousand now.

Where did this return mostly come from? It's current price to sales ratio is now 9.8 times, meaning that now the company is a global darling, on the forefront of technology, investors are a lot more optimistic about its prospects than before. So, there was certainly a gain from the company's increase in multiples.

But the company's sales increased by almost 28% per year, an astounding growth. From 1.3 billion they skyrocketed to 15.8 billion dollars. This growth combined with the increase in valuation made the company reach the top of global returns

Sales in 2008: 1.3 billion dollars  
Market cap in 2008: 1800 MM  
Price sales ratio in 2008: 1.34  
Sales in 2018: 15.8 billion dollars  
Market cap in 2018: 116.8 billion dollars  
Price sales ratio in 2018: 9.8  
10-year annual return: 52.12%

Amazon is a similar story to Netflix: it was not particularly cheap back in early 2009 with a market cap of 22 billion and a price to sales ratio of 1.2. But in the next 10 years sales rose to 232 billion and market cap to 737 billion. In other words, once again, unbelievable growth and world domination combined with a gentle increase in valuation made the company reach the top.

Amazon

Sales in 2008: 19.166  
Market cap in 2008: 21.947 MM  
Price sales ratio in 2008: 1.15  
Sales in 2018: 232 billion  
Market cap in 2018: 737 billion  
Price sales ratio in 2018: 3.17  
10-year annual return: 38.61%

## 2. The value class

But there is more to the top of the leagues return story as any value investor might point out. Let's take a look at a fantastic company this house loves to observe from time to time: Corticeria Amorim, a middle-sized family owned Portuguese company that dominates a stable and not too exciting business of cork production for premium wine bottles worldwide.

Common sense would tell us, even before looking at the financials that this is not a startup business with superfast growth. Over the past 10 years, sales at Corticeria Amorim grew slowly but consistently from EUR 468 million to EUR 753 million. A stable and consistent business that dominates a niche. The kind of business Warren Buffet might be interested in if he knew about it.

But how can a company that didn't even double its revenues over the past 10 years be one of the top performing stocks of the past decade? The answer is mainly valuation: 10 years ago, Corticeria Amorim was a forgotten stock trading at an incredible low price to sales ratio of 0.23. It will never be a growth stock, but after the financial crisis, liquidity improved, sales maintained their consistency and the company now

trades at a more normal 1.70 price to sales ratio, bringing the 10-year total return to around 26%. To put that in perspective, a return like that would make \$ 1000 turn into \$ 10 000 over the course of a decade. Certainly not bad for any investor.

Sales in 2008: 468 million  
Market cap in 2008: 107 million  
Price sales ratio in 2008: 0.23  
Sales in 2018: 753 million  
Market cap in 2018: 1.284 million  
Price sales ratio in 2018: 1.70  
10-year return: 26.27%

### 3. The hybrids

As the reader might have guessed, there is every imaginable combination between growth and value, between companies that expanded their revenues very fast in this decade and companies that were unfairly neglected and then got discovered by value investors and had its multiples converge to more rational levels maintaining their consistency.

The glue that keeps everything together in our minds is the price sales ratio. Not forgetting of course so many important analysis metrics this house uses daily, like Free Cash Flow (FCL is in Portuguese an abbreviation of this metric), dividend yields and so forth, we think price to sales ratio is unfairly neglected as useful indicator for assessing the valuation and evolution of a company. It doesn't get the respect it deserves!

In one extreme in the top performers we will find companies that had moderate or even high price to sales ratio 10 years ago but then experienced a skyrocket in its growth (like Netflix and Amazon), in the other extreme very cheap companies that had moderate but consistent

growth but together with a convergence in valuation brought astonishing returns to its investors like Corticera Amorim did.

There are also companies somewhere in the middle: very fast growth combined with significant increase in valuation, like for example, Raia Drogasil from Brazil and Booking.com from the US:

## Raia Drogasil

Sales in 2008: BRL 1260 million  
Market cap in 2008: BRL 590 million  
Price sales ratio in 2008: 0.47  
Sales in 2018: BRL 14.305 million  
Market cap in 2018: BRL 20.536 million  
Price sales ratio in 2018: 1.43  
10 year annual return: 31.37%

## Booking-BKNG

Sales in 2008: 1884 million  
Market cap in 2008: 3018 million  
Price sales ratio in 2008: 1.60  
Sales in 2018: 14.117 million  
Market cap in 2018: 88.319 million  
Price sales ratio in 2018: 6.25  
10 year annual return: 38.60 %

All of these findings are fascinating because they allow this house to track the evolution and returns of different securities over time. "Invert", said

Munger. Well, to be able to do that, we have to ask, “how did the winners got there”?

Over the years this study not only reinforced the value investor mindset we already had but the findings even put us more clearly in a specific camp inside the value investing school: the so called GARP (growth at a reasonable price) framework.

While classic value investors almost completely disregard future projection and focus on traditional valuation metrics, especially low multiples and growth investors are willing to pay high premiums for the best companies, we feel that the middle ground, the growth at a reasonable price school provides us more different routes to success.

For example: we might be wrong about a portfolio company’s growth trajectory but as long as we didn’t pay too high a price, at least the downside will be mitigated (the famous Ben Graham’s margin of safety).

At the same time, as any classic value investor knows, value traps are the permanent enemy: the companies that become losers in the merciless corporate race won’t be able to produce returns no matter how cheap their stocks were bought in the first place.

That’s why warren Buffett’s famous “conversion” to quality, turning away from solely buying securities at low multiples gave birth to his most prolific phase. Maybe not knowing he was converting to the GARP school too.

Turning to quality, it is said, is a route many previous quantitative classic value investors, like this house, did and our route was not different. That’s not to say we don’t pay attention to valuation anymore, quite the

contrary. It just means that in different companies we might look for slightly different routes to victory: we might be willing to pay a little more as long as there is a corresponding increase in quality and prospective growth.

The ideal of course would be a high quality and growing business at very depressed multiples. But usually ideal is something not found in real life unless in rare circumstances.

So, one permanent “dream session” for this house is to think about the future of our portfolio companies. How might Anta perform in the next 10 years? Or Match? Or Minerva?

Some of our past investments were clearly more focused on multiples convergence and valuation (Braskem most obviously and now VTB, Russia’s second largest bank) and sometimes we were willing to pay a moderate premium for top quality (Anta, Match group).

Each case is different, but if we had to divide, we would put in the Value convergence thesis as the basic framework for this house’s investments in Braskem, VTB, Minerva and Dufry; while we were impressed by the quality, prospects and willing to pay higher multiples (not completely disregarding valuation ) with our investments in YY, Match, Log In, Yatra, Ctrip, Anta and others.

Obviously, in each of these cases the reasoning was different and many of them have both a quality as a cheapness attraction.

This exercise, to wrap it up, is both about offense (trying to look for tomorrow’s winners that might make the 2029 screening of top

performing stocks) and defense (constantly monitoring our portfolio and looking for exit routes for our investments - are they still cheap? Are their prospects still exciting?)

Among the many arts necessary in investing is the art of observation and monitoring. Like a painter with many brushes or a cook with many utensils, in our work we also have many tools. This is one of them.

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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