

# FCL*Capital*

2Q 2020

## 1 - The future - How can you tell?

On the evening of June 19th, 1984, executives and coaches from the National Basketball Association were reunited at Madison Square Garden for their annual draft session.

For those of us who are not fanatics about the game, the annual NBA draft evening works like this: between NBA seasons there is a formal drafting event, and every new player who wants to join the league needs to be drafted, picked, by one of the NBA teams. There is a ranking among teams of who has the first pick, the second pick, and so forth, based on previous teams' rankings and a lottery process.

So, in that evening back in 1984, the Houston Rockets got the first pick of the draft. They could choose first whichever player they wanted to be part of their roster, among any of the promising talents that dreamt about being picked, signing a contract and joining the league, just fresh out of colleges across the United States.

The Houston Rockets pick a player named Hakeem Olajuwon.

By any measure Olajuwon had a formidable career and was a tremendous player: born in Lagos, Nigeria he would reach the league, got chosen as a first choice for the draft and would years later, lead the Rockets for two NBA titles and the USA national team for a gold medal in the 1996 Olympics in Atlanta. He was indeed the favorite among bookmakers to be drafted first. Remember, this was no accident: obviously given the millions of dollars involved every NBA team had an extensive network of contacts and knowledge about college teams across America and their players. They knew who the most promising ones were. And indeed, Olajuwon turned out in his career to be as good a first pick draftee as they usually turn out to be.

For the second pick it was Portland Trail Blazer's turn. After some back and forth they ended up, in what is probably one of the worst decisions in the history of sports, picking a player named Sam Bowie.

Bowie's career was marked by a series of injuries and he never really was able to be a consistent player in the top league. His career did last almost a decade, so he was not a complete disaster, but it really had no big sparks, no titles, no special honors. He was a mediocre NBA player and given his amazing record as a college athlete that made him the number 2 overall draft pick, more was to be expected.

Then it was time for the third pick. Each year there are usually one or two really outstanding promising athletes so in any given year the number 3 pick is worth a lot less than the number 1 or even number 2 pick. But anyway, the night had to go on. There were still more young players dreaming of a shot in the NBA.

For the number 3 pick it was the Chicago Bulls turn. They picked a young shooting guard from North Carolina University who was tall, thin and athletic. Today, the NBA Hall of fame simply states that by "general acclamation" he is considered the greatest basketball player of all time. He would lead the Chicago Bulls, who had never won an NBA title, to six championships, he would lead the so called "dream team" the USA basketball team widely considered the greatest ever, alongside players like Magic Johnson and Larry Bird, not only to an undisputed gold medal but to the very rise of the NBA, the sport of basketball and even American culture itself, to a new international prominence in an era of globalization. Of course we know that by now, dear investor, even if you have never watched a basketball game in your life, you very much know who this house is talking about: as pick number 3 in that evening back in 1984 the Chicago Bulls chose Michael Jordan.

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The theme of this letter is about the ability, or more often than not, the incapacity of we as human beings to predict the future and avoiding being completely clueless about what the days ahead hold for us. This is of critical importance since investing is, at its heart, a probabilistic activity, and all investing in one way or another is a speculation about what the cards hold for us in the future.

If there is any additional need to begin our journey with humbleness, think about this: NBA executives and coaches back in that evening in 1984 were no fools. They knew the game deeply. They certainly even had extensive contact with college teams' coaches. They were the elite of this sport in the world. It is easy to laugh at the Portland Trail Blazers foolishness and even at the Houston Rockets. How could they not spot greatness? They had the best ever lying there for their picking and let him pass!

But the truth is the future is a messy place. The world is full of moments like this. Talented venture capital investors that just say no to investing in a Uber or a Google or a Facebook letting their founders know they should give up on their dreams and complete their college degrees since that will be the best for them. The world is full of NBA coaches that pick Sam Bowie over Michal Jordan. Of record companies' executives that bet in some band that never go anywhere instead of the Beatles. Is it possible to even tell? To have some clue? To have at least a better than average picking rate?

With this exploration we continue a journey we first discussed in our November 2015 letter (<https://tinyurl.com/nov2015eng>) where we asked when discussing the Guns and Roses, Apple and other phenomenal human achievements: what are the ingredients that when combined, this explosion occurs and we see greatness? How to spot greatness before anyone else? Where to look for?

So in this letter we focus on the human ability ( or lack thereof) to see the future and is more related to our process of trying to predict the direction

of the companies we invest in the future and in the next letter we discuss the search for excellence and is more related to our framework for analyzing management teams and business decision making.

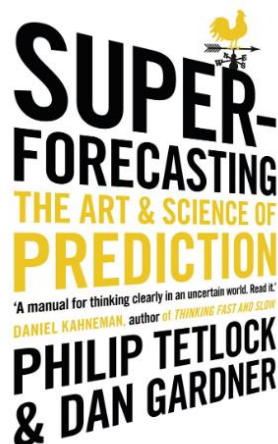
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So, we start by the central question: is it possible to know if a company will turn out to be a Facebook, an Uber? Was there any hint to know that that skinny athletic shooting guard from North Carolina would turn out to lift not only his team, not only the very game of basketball, but also the whole NBA, and even American culture?

Yes and no we think. Like any competitive endeavor, it's never about knowing, it is about pushing forward, beating the competition, getting better, being good and evolving. Occasionally you will let an Uber or a Michael Jordan pass and that's ok. After all, let's not fool ourselves: not even the Chicago Bulls had any idea that Michael Jordan, the number 3 pick, would turn out to be, Michael Jordan, full stop. Likewise, no early investor in Google, Facebook and other household names had a complete idea their company would change the world. Peter Thiel, one of the greatest Silicon Valley investors and an early Facebook investor argued with Mark Zuckerberg that Facebook should accept a billion dollar proposal to sell itself. The same company is worth today over a half trillion (with a T) US dollars and Thiel himself is a multibillionaire because a young Zuckerberg said no.

So how do we get better? How do we move forward?

There were two books that were very helpful in this house's process to access our framework for analyzing companies, the general global economy and its society, and trying to guess where things are going. They are Phillip Tetlock's Superforecasters and Hans Rosling's Factfulness



Among the many amazing insights of Tetlock's book is the assumption that instead of being a Hedgehog and viewing the world through a single idea, we should be Foxes: adaptable, malleable, with permanent eyes of curiosity. We should start from a base rate and go from there.

We would add that we should not only be foxes, but also cockroaches: adaptable to survive. You should be aware, dear investor, that in this permanent game of trying to guess the future better than our competitors, in many ways this house starts behind: we don't have the budgets, resources and networks of our giant competitors from New York City and London. But everyone starts somewhere unique in the universe and this should be made an advantage.



Not good enough for draft pick number 1

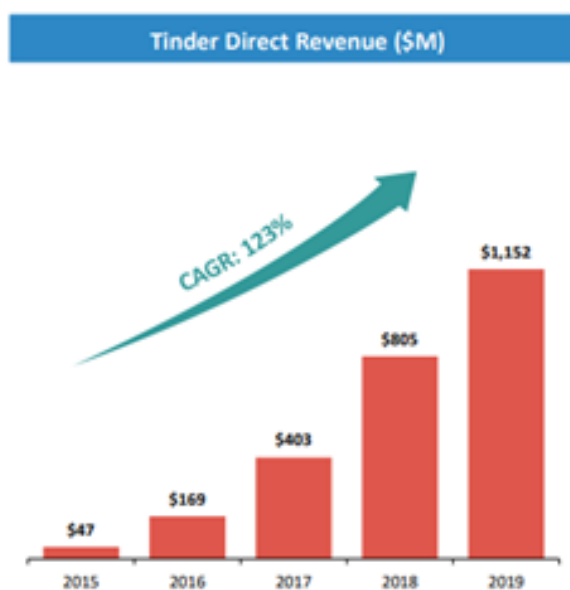
This manager started to become intrigued many years ago with Tinder's surging popularity among Brazilian millennials while no one in Wall Street even dared to put any international revenue projections in the company's reports.

Then one day in an Uber ride in Rio de Janeiro the driver lamented that he used to work all night taking people to night clubs but "kids those days only go to bars with dates already set in this phone app".

From there it only took some reasonable assumptions, some imagination that people's tendency to think that the future will only be an extrapolation of the present would be surprised, and some more work until Match eventually became, a couple of years later our largest investment. Cockroaches. We had many disadvantages : we were far from the company's management that sits in Texas, we ran a very small fund (which we still do but even more so back then) but our unique point in

geography, allowed us to see Tinder's globalization and the fact that it would become a global phenomenon before most in wall street.

Since not everyone can be born a male, wealthy, white swiss person (not that this would make anyone better but it would certainly give this person advantages and head starts) than we try to make the most of our unique perspective in the world. What we can bring to the table. The main point is: since everyone's perspective of time, place and experiences is unique everyone is ahead of the competition in something. Everyone knows something that no one else knows. And the secret is choosing to play a game that suits you. As for the Uber driver that tipped us into our greatest investment, before you ask, dear investor, we did try but never were able to locate him again to give him the hell of a tip he deserved.



We start the letter talking about Match because this past quarter carries all the bittersweetness of the fact that this house, after six years of involvement with this amazing company sold its remaining stake in Match (see performance section).

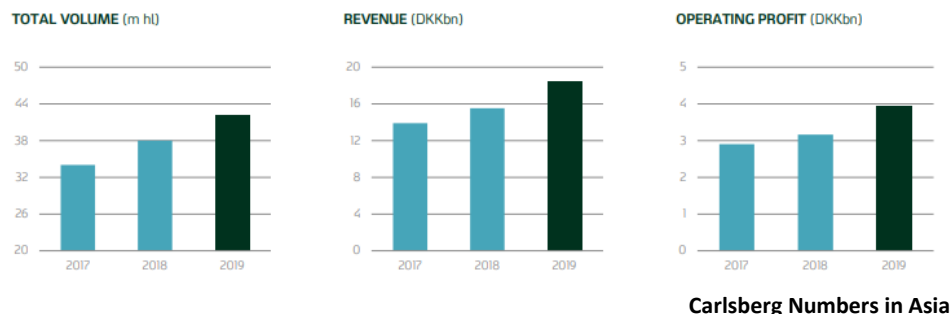


But let's look at a more recent investment: Carlsberg, the Danish brewer. Since Carlsberg is gaining popularity in Asia, especially in China's west region where it enjoys a strong moat, it is fair to ask: what is the future of consumption in Asia (the future, again...)

With some reasonable inferences and the help of those two brilliant works, here are some of our macro assumptions about the investment, before even looking at its financials and corporate governance:

- a. Asia's incomes and consumption power are rising fast and will continue to rise in the next few decades
- b. As their incomes rise, Asia's consumption will become more westernizing, with its consumers wanting to be part of the "global village", wanting access to the brands they know bring them status, from Hermes bags to Carlsberg beer.
- c. Why, it is fair to ask, will Asian consumers crave mostly European brands? Because despite the fact that the Americans are the winners of globalization in the past half century, at least in one area the Europeans won: they are the arbiters of taste, they are the ones that confer prestige, they get to decide which is good and tasteful and what is not in a way that American brands simply can't, at least when it comes to personal consumption (tech being a different story).

All of those combined facts helped to inform this house's framework about the industry. This is not to say, of course that we don't spend a lot of time looking at financials, internal competition, and the particular dynamics of companies. But to this date after a year we first disclosed our investment in Carlsberg in this very space, we only had two brief contacts with the company's management, one of them through a phone call and just a brief presential one in a financial event in New York City.



Our thesis in Fleury, another one of our present day's largest investments is also an assumption of linear progression happening in the not so distant future (linear progressions are sometimes broken but usually not when it comes to demographic tendencies): Brazilian population is both becoming older and more affluent and this combination usually makes demand for health care services like diagnostics to skyrocket. So, we start the company's analysis knowing and understanding this long term tailwind for the company.

As for the book, Factfulness, another fascinating book, one valuable insight is that we should try hard to combat some of our instincts when we look at the world: excess negativity (in part fueled by media and short term thinking), extrapolation, generalizations, and so forth.

FACTFULNESS POSTER

# Dramatic Instincts

1 The gap instinct



Look at the gap!

2 The Negativity Instinct



It's getting worse!

3 The Straight Line Instinct



It just continues!

4 The Fear Instinct



It's scary!

5 The Size Instinct



It's big!

6 The Generalization Instinct



They are all the same!

7 The Destiny Instinct



It never changes!

8 The Single Perspective Instinct



This is the solution!

9 The Blame Instinct



That's the bad guy!

10 The Urgency Instinct



It's now or never!

Of course, since everyone has a unique point in time and place, everyone should be better able to spot early tendencies, to connect the dots in some specific aspect of life than most. If you wanna know before everyone else about new promising startups, Silicon Valley and increasingly, the bay area of China are the places to be. If you wanna have an endless flow of financial information, then wall street bull is still standing.

This house figured out, however, that since we can't compete in those games we will dedicate our lives and purpose trying to understand which ideas and business have global potential and can be transported, transformed and made profitable across cultures and income ranges. Especially between the developed markets of US and Europe and the BRIC countries and vice versa. In other words, we won't be the first investment house to invest in Match or Anta while they are still national companies with national ambitions but we will try to be among the first to realize they have global instead of local potential.

And new tendencies will always keep coming. This is how societies worked since the dawn of time, from new routes to India to the work from home revolution that made the world's back office systems be moved from skyscrapers to kitchens and bedrooms in the space of five weeks.

New tendencies might yet bring deep implications to companies we have invested in the past, like Zoom and IWG. The good news is that the global economy keeps flowing with this improvisation. Ships and airplanes still cross the planet, derivatives are still being traded, and so forth. The bad news is that the global economy keeps flowing with this improvisation. People still haven't fully grasped the magnitude of the changes, with its diverse set of opportunities and threats, this might represent. Mindsets are harder to change than technology. What will this new paradigm mean for airline, cruise operators, malls, real estate companies?

As always, time will tell, and financial prices are in the end information: when making bid and sell orders investors are essentially looking for the truth. And in this search everyone should count on the unique place in time and geography they occupy, since everyone can bring a unique perspective to the world, and also to rely on the amazing framework like the writers we mentioned and other, to not to be alone in this journey but instead, as Newton once said, to be standing in the shoulders of giants.

## 2- Performance

FCL Opportunities	
Year to date, 2020, USD	-15,36%
Year to date, 2020, in BRL	14,95%
MSCI ALL Country Index YTD, 2020	-7,14%
FCL Opportunities, since Inception (30/01/2017), USD	23,41%
FCL Opportunities, since Inception (30/01/2017), BRL	116,16%
FCL Opportunities, avg annual Return, Since inception, USD	6,33%
FCL Opportunities, avg annual Return, since Inception BRL	25,08%

FCL Hedge	
Year to date, 2020	-1,30%
Year to date in % of CDI	-73,86%

Throughout the second quarter, both of our funds continued their recovery from a bad start of the year.

FCL Opportunities increased by more than 36% in Brazilian real (and more than 22% in USD) and is now up almost 15% in 2020 in BRL though still slightly negative in USD due to the sudden appreciation of the US dollar not only against the Brazilian currency but against the currencies most companies in our portfolio book their revenues.

Since our inception in January 30th, 2017 FCL Opportunities has been one of the top performing funds in its category, with average annual returns of more than 25% per year in Brazilian real. When measured in US Dollars our returns are less stellar (around 7% yearly) but this house is confident that over time returns in different currencies should converge since no currency can keep appreciating indefinitely against its peers with no corresponding difference in inflation. And we are indeed very bearish on the US dollar as an asset at this time.

As for FCL Hedge, it has also shown a good second quarter, with its shares appreciating by more than 6% and almost coming back to positive territory in 2020. In the second half we will work hard for Hedge to finish the year in the black.

At the end of the second quarter the top 5 positions in FCL Opportunities where:

Position	Country	% Fund NAV
Anta	China	14,52%
JOYY	China	14,43%
Vipshop	China	10,82%
Yduq	Brazil	8,76%
Carlsberg	Denmark	8,41%

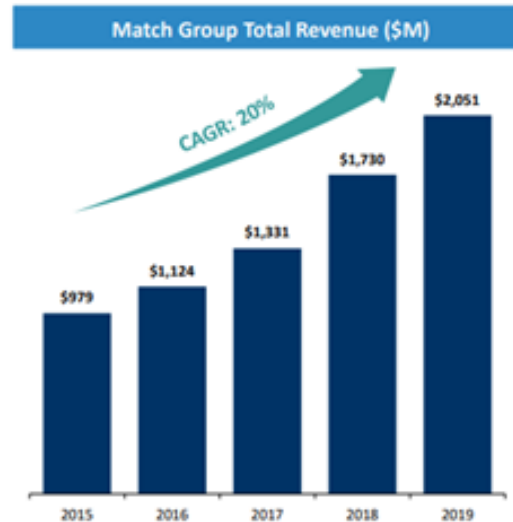
As for FCL Hedge, the portfolio composition in June 30th, 2020 was:

Positions in brazilian ETFs and stocks	71,91%
Positions in brazilian fixed income	19,18%
Other positions	12,64%

Many investors have been asking about the direction of our portfolio for the second half of this year. Some have asked about one of our most discussed positions: Match Group.

As we mentioned in the previous section, in this quarter after six years of what was certainly one of the deepest and most important investments of our history, we finally sold our remaining stake in Match Group. We still think the company has a great future ahead but its current valuation seemed reasonable for us and with the decreasing margin of safety we felt

the time and our general uneasiness with the global optimism about US tech platforms, the market's realization that as our thesis stated Match is one of the great tech platforms that was previously overlooked, we decided it was time to part ways and cheer for Match from some distance after so many years of watching the company growth and surprise its skeptics.



The selling of our stake in Match and the almost complete absence of US positions in our portfolio are connected. If this house had to summarize, we would state that:

- a. We have become increasingly worried about sky high valuations in the US markets in complete divergence with the rest of the world, especially large cap technology stocks and the Nasdaq Index.
- b. Not only that but the world is still in complete wonder about US capitalism, its companies, and its tech champions. It seems it's 1999 all over again.
- c. Meanwhile emerging markets, commodities and some amazing European companies are completely forgotten.

As it usually happens, we are taking the contrarian approach. Our decision is to become overweight in Europe and emerging markets (especially Brazil and China) and underweight US tech. We think the Nasdaq is due for a correction.

As for European companies one of the themes our Opportunities fund has been exploring for years is becoming even more important: although it may be true that amazing American and Chinese companies will be the major champions of the 21st century, in at least one very interesting niche the Europeans remain above the rest: as we discussed before in this space, Europe is home to most world class consumer brands and their prestige remains the arbiter of what is good and timeless and what is not. From Rolex watches to San Pellegrino water to Hermes bags to two of our investments in the old continent: Moncler clothes and Carlsberg beer, it is to European brands that young and increasingly affluent Asian consumers (not to mention American consumers before them) turn their hearts and their wallets to state: “I have arrived”.

Over the next few decades our Opportunities fund will keep looking for many unlikely champions of globalization in old European clothing, food and personal product overlooked names that can convince young Asian, middle eastern and Latin Americans that to “arrive” they need a glass of their wine, their fragrance, their shoes.

As for the coronavirus crisis as expected our portfolio companies experienced different fates: for some it was even a tailwind, helping their sales (increased time online for Match and YY, higher Iron Ore price for Vale) for some it had little impact (Fleury in healthcare, Vipshop in discount internet retailing) and for some, especially the ones that rely on physical presence and tourism, it was an important setback ( Moncler and Capri and its luxury fashion stores and also , contrary to what some believe, Fu Shou Yuan, the Chinese funeral company, that books a third of its revenues in funeral services that can't be performed due to physical distance requirements and attendance restrictions).



Overall, however, we think our portfolio performed very well against the shock in the first half of the year and none of our investments is in severe distress or fundamentally threatened in the long term because of these difficult times we are facing.

As for the school of thought that maintains that the world will be a fundamentally different place once we emerge from this, we are mildly skeptic: we do agree that a new line of equilibrium will be found in some things like working from home more often and a heavier use of technology against labor, but more often than not, things will be back to something that closely resembles the recent past. Indeed, if there is one precedent in the world, from Ancient Rome to modern day America, is the belief that we are so special that we live in unprecedented times.

A case in point: Amazon. This house would never deny Amazon is an incredible company with an amazingly talented founder in Jeff Bezos. If this manager could close his eyes and choose to be the owner of one company for the rest of his life that would probably be it. Still, if we adopt a different framework, if we travel in space and time at least intellectually like this house loves to do, we see there's more to the debate than an irreversible move from physical consumption to online retail. There are actually progressive rounds in this fight, some of them won by different opponents and it will probably remain this way.

In fact, if Amazon has one precursor it is Sears. Back in the 19th century when most Americans lived in small rural communities scattered across the country, Sears was one of the USA's main companies delivering products by mail. Over time as people moved to the cities and retail chains first appeared, Sears lost its prominence to the Best Buys, the Wal Marts and the Macy's of the world.

Likewise, dear investor, you can be certain that in capitalism no prominent position lasts forever. Maybe physical retail will up its game to compete with Amazon and its peers, just like 20th century retailers were able to

dethrone Sears, maybe something new will come up, but as certain as the fact the sun will rise tomorrow you can count on the fact that the champions of today, those formidable companies from California we all love like Google, Amazon, Apple and Netflix, won't be the champions forever.



## Sears catalog: Online juggernaut of its time

## 3- Thesis: VTB Bank

When we first launched our Opportunities fund back in 2017, with the vision that a search for overlooked global ideas would lead to consistent returns, we knew that most opportunities wouldn't be found in the most famous corners of the planet's financial markets. In other words, we committed to being contrarians at heart and to feel joy instead of fear in being alone in our positions and preferences. We are used to cause annoyance, confusion with our thesis and that's part of the game. Having a position in Google will put you at the center of the cocktail party but might not do much for your bank account.

This is how this road led us to a journey of study, discovery and fascination over the past year about global banks. Since the dawn of commerce when it was first used to provide currency exchange and credit to merchants in Europe's and the Middle East villages during the middle ages, banking activity has had a prominent role: it is what makes the global economy tick. It is also how many of the planet's fortunes and dynasties were made in past centuries: from the Rothschilds to John Pierpont Morgan. But at the same time, in this fast paced, online obsessed century, especially after the global financial crisis in 2008, banking activity was remodeled and lost a lot of its shine in stock investors hearts and minds.



MSCI All country index (blue), Global Banks (green), Information technology (purple), past 10 years

To sum it up, the same instinct that made us curious about an overlooked startup dating company called Tinder and its parent, Match Group, back in 2014, today makes this house curious about global banks. It is simply where no one wants to be. Where no one perceives value.

Before we even start: there is admittedly a lot to be said about how banking activity has indeed changed after the global financial crisis. The old days when investment bankers would significantly put their own capital on the line to close deals seem to be gone for good.

Indeed the combination of new regulation and their demands for a higher capital cushion, the undeniable threat imposed by fintechs on some of the most profitable business lines, the lost market share to more nimble hedge funds and private equity firms in others make banking activity in general to have lower returns, their ROEs and profitability will remain fundamentally different than in the past in most parts of the world.

The good and often overlooked bright side (and every occurrence in life brings a bright side) is that if returns are lower due to the above mentioned reasons, they are also more predictable. Indeed, one interesting line of thought, funnily enough adopted, it seems, by the Chinese government, is that banking is a utility. Banks should serve the economy, not the other way around, and therefore they shouldn't be allowed to become volatile. And for stock investors, that means their valuations should start to reflect that. Multiples closer to gas companies and further away from sexy and volatile cyclical industries.

That being said, there is a lot of hysteria about the threat of fintechs, the disappearance of global banking as an activity, the erosion of value of banking franchises and the naive thought that it would be easy to replace some of the business lines global banks provide. With its myriad of revenue streams and their irreplaceable role at the heart of international commerce and finance, from IPOs to corporate credit lines, from international exchange to advisory in global mergers and acquisitions,

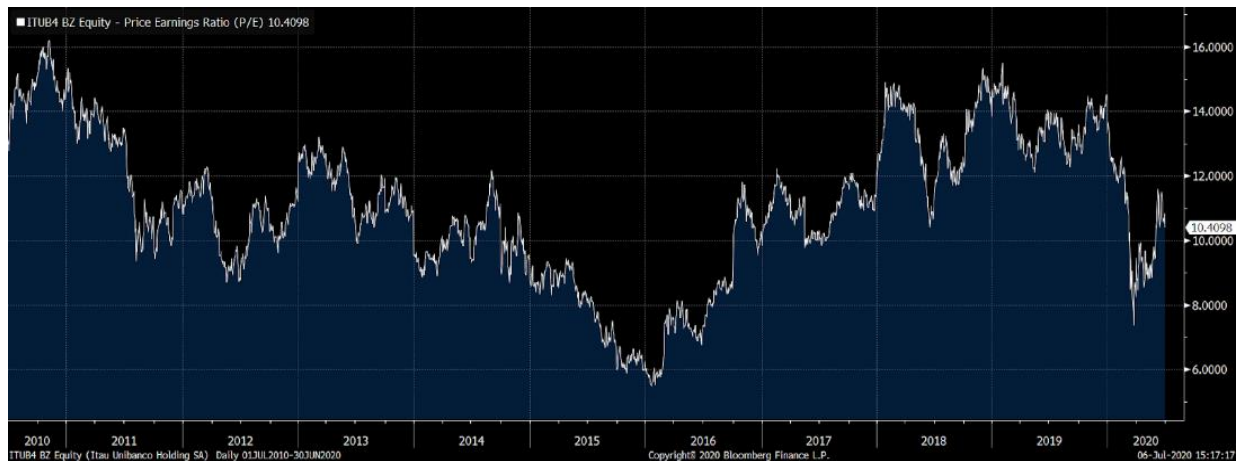
most banks are not going to be completely replaced in the next few decades at least.

In the scope of this thesis we will focus on banking in emerging markets since this is our main focus. A lot could also be written about banking in the US and Europe but we are going to leave that for another opportunity.

Starting in Brazil, a country where the leading commercial banks play a more prominent role than in most places and historically Brazilian banks and profitability was above its peers elsewhere.

If we look at Itaú, Brazil's largest private bank's valuation history, an interesting pattern has emerged: for most of the past decade its Price/Earnings indicator has hovered between 8 and 10, which seems fair to us, given its consistently high Return on equity ( although there are signs this could change over the next few years).

During the Brazilian political crisis in 2015, however, Itau approached a scary Price Earnings multiple of only 6, putting it close to Russian levels. In other words, as any emerging market, during political and economic crisis, Brazilian companies get an extra discount.



Itaú's price earnings Ratio over the past decade

As for this house's other bank investment, HDFC from India, the story is the reverse: HDFC trades at a premium to most global banks and rightly so, since it is one with the few banks around the world with a fascinating long term growth story: it is the leader in providing home mortgages for millions of Indians though its vast networking of branches across the country, especially in rural and semi-rural areas.

India is a very young and still a very rural country. For the remaining of this century its population should have a very high rate of household formation and urbanization. Meanwhile, India's banking sector is mostly state owned and terribly run as its recurrent banking crisis attest.

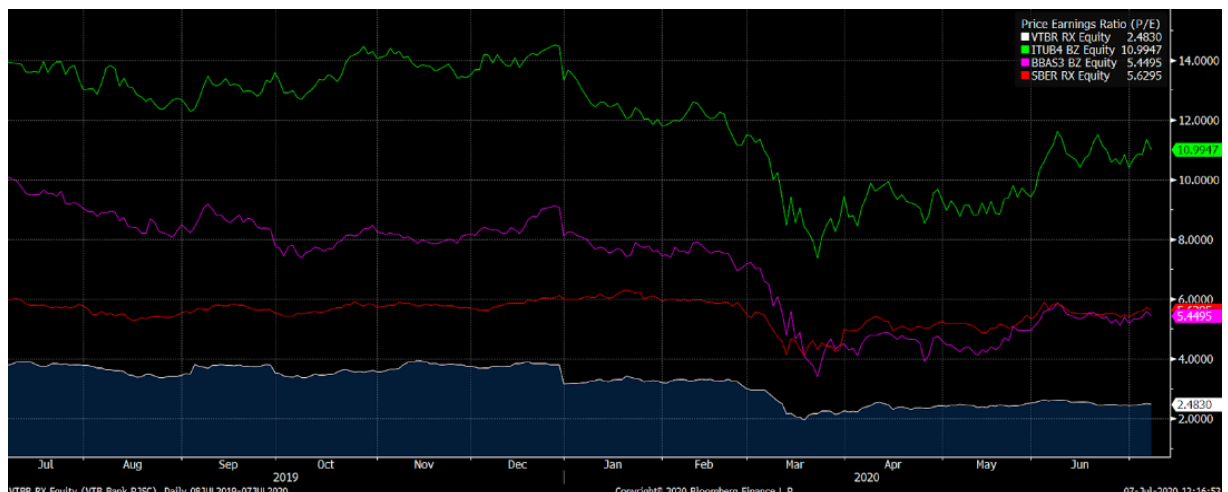
So, in short HDFC enjoys comparative advantages and a strong moat around niches that are incredible growth stories for decades to come and against crumbling competition.

This house had a position in HDFC in the early years of our Opportunities fund but struggled with it since the company is always so well priced in the markets. With the coronavirus crisis however HDFC shares nosedived and we saw this as a wonderful opportunity to once again build a stake at this fascinating company.

This thesis will focus on our investment in Russia's second largest bank, VTB.

As most would expect, the banking sector in Russia is state owned, although surprisingly professionally looking. It is undeniable that the country has a terrible reputation abroad but from its competent Central Bank, to its professional regulators to the corporate governance of its state companies, Russia is ahead when compared to the quality of management of state owned companies in Brazil, India or China. To stay in just one example, for Brazilian investors, when we look at Sberbank and VTB, Russia's two largest banks, their corporate governance, accounting transparency and disclosures seem frankly better than what can be seen in Brazil's national bank, Banco do Brasil.

This is not to deny that Russia as a country should have an extra discount, for obvious reasons. Sberbank, the country's largest bank trades at a PE around 5. We do think that even considering Russia's obvious shortcomings and country risk, its banks valuation seems a bit harsh. It is very hard to even come up with any projections that would bring downside to an investment in the country's banks or general stock market for that matter.



Banks Price Earnings Ratio: VTB (Blue), Itau (green), Burbank (Red), Banco do Brazil (Purple).

Besides, if the country's banks don't aim at western style profit maximization, that is less of a downside at a time when the whole global banking activity is going through a transition to functioning as utility companies. In an interesting twist this is not much a problem for Russia and China because, well, that has always been the case for them.

Around a year ago we built a position in Russia's second largest bank, VTB. Unlike Sberbank, VTB doesn't have a very dense branch network across the country, which might even be a good thing since this house thinks its business model is less prone to disruption than its larger rival's. To put it in very simple terms, Sberbank is the leading commercial bank while VTB resembles more closely a leading investment bank being more focused in investment banking and corporate credit although it does have a retail arm. More importantly, it enjoys a stable lending book to Russian companies and what we think are adequate provisions.

If Sberbank's valuation already seems too harsh and pessimistic to this house, even accounting for Russia's immense share of problems and uncertainty, we think VTB's valuation is simply insane. It trades at a PE ratio around 3, a level we think it provides its investors with a huge margin of safety: a recurring dividend yield north of 15% once VTB's tier 3 capital ratio is replenished later this year, a market value that is under half its book value and a market value of less than three times its annual recurring earnings even considering Covid related provisions. It also adheres to global standards: we bought our position in London's stock exchanges since the threat of currency controls and the Russian jurisdiction would be too much even for this house. Not a single cent of our investment has physically entered Russia, nor it will in the foreseeable future.

Bellow we build a proprietary model with our PE projections for 2021 divided for the company's current ROE for five companies. Currently this house only has investments in VTB and HDFC and all other banks are included only for comparison purposes.



Company	PE Ratio (2021)	Recurring ROE	Multiple
Itau	10,50	15%	0,70
Goldman Sachs	10,00	9%	1,11
Citi	9,00	6%	1,50
Banco do Brasil	6,00	10%	0,60
HDFC	17,00	18%	0,94
Average	10,50	11,6%	0,97
VTB	4,00	12,0%	0,35

The simple above exercise would provide a theoretical upside of almost 150% for VTB's shares when compared to a selection of global peers or almost 50% when directly compared to Banco do Brasil.

Of course, there are a lot of assumptions in the above numbers as well as some bias in the comparison's selection. But this simple exercise would prove VTB is possibly the world's cheapest global bank. We think this opportunity arose due to a combination of factors:

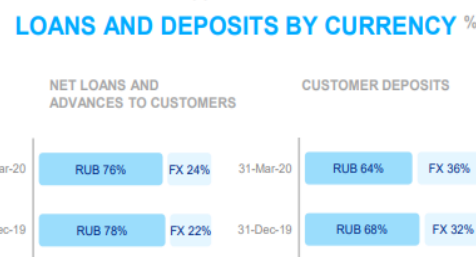
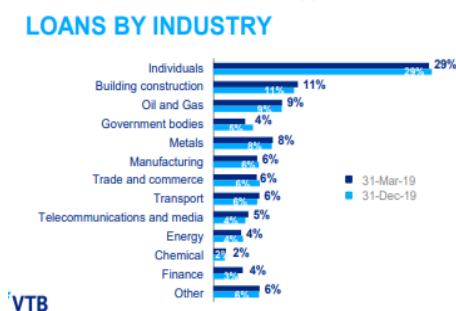
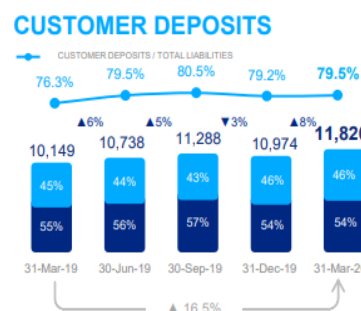
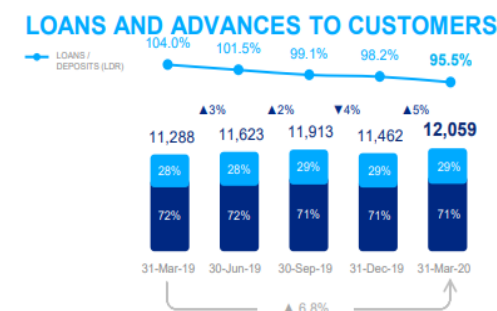
- a. Global investors general pessimism and antipathy towards the sector
- b. Global investors general pessimism and antipathy towards the country
- c. The fact that this year exceptionally VTB won't be paying the same level of dividends to replenish its tier 3 ratio, making investors that were in its capital base for its annual dividend stream to sell their shares.

Now, we are not naive of course. This house is not denying Russia should get a huge discount, even when compared to Brazil or India, let alone the US market. There are some serious risks in the thesis, like a) Russia's

international situation could keep worsening, with new sanctions b) The global economy and the coronavirus crisis takes a turn for the worse leading to more provisions and an erosion of the bank's profitability.



VTB Bank Price earnings Ratio (left 1), Price to Book Ratio (left 2) and Dividend Yield (Right), 2016-2020



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No profitable investment is without risks. Overall, we find the bank's surprisingly good corporate governance, its adherence to global standards and what it seems to us a very attentive work by the auditors very powerful risk mitigators. Overall, we judge the risks well over taking.

Although we didn't put that in our projections, an amazing extra prize would happen if Russia someday ends its Putin era and reemerges to take its place in the league of outward looking, peaceful, and global nations. This alone would certainly make this house's investment in VTB multiply its value many times over.

It is, to use market's terminology, an out of money free option. But it also is a thought we raise a vodka toast to.

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