

FCL *Capital*

4Q 2020

The Frontiers

“To boldly go where no one has gone before”

(From “Star Trek”)

There are decades when nothing happens and there are weeks, or even days, when a decade happens.

In the early hours of July 7th, 2019 this house was suddenly facing one of its most challenging times. We were living a decade in a day.

Being a global investment partnership, we got used over the years with the global time difference. Since in most days this manager sleeps in the western hemisphere it is a consequence of the planet’s rotation that most of Asia’s and China’s business hours will be spent in dreamland. True, it is rare a sleep night not interrupted by a 3AM wake up to “check on everything” on the other side of the planet, that part of the world so far away physically but still so present in our daily thoughts. Still most mornings are for us, as for most people, the promise of a fresh and familiar start.

But not on this one. On the morning of this eventful day, something out of ordinary was happening.

One of the most famous short seller hedge funds in the planet¹ had just released a 92-page report² on a Hong Kong listed company called Anta, an athletic fitness brand. The report basically stated, in a very detailed fashion that: a) Anta was a fraud, b) It

¹ Short sellers are investors that bet that stock prices will fall

² https://d.muddywatersresearch.com/content/uploads/2019/07/MW_ANTA_20190708_PART_I-1.pdf

maintained secret and illegal relationships with many of its directors, suppliers and retailers, c) It had fake shareholders.

Over the following four weeks Muddy Water went on to release no less than four additional reports claiming and detailing in a very precise fashion among other things that Anta's relationship with Fila, the Italian brand for which it holds exclusive rights in China, was also fraudulent and the accounting surrounding the company was dubious.

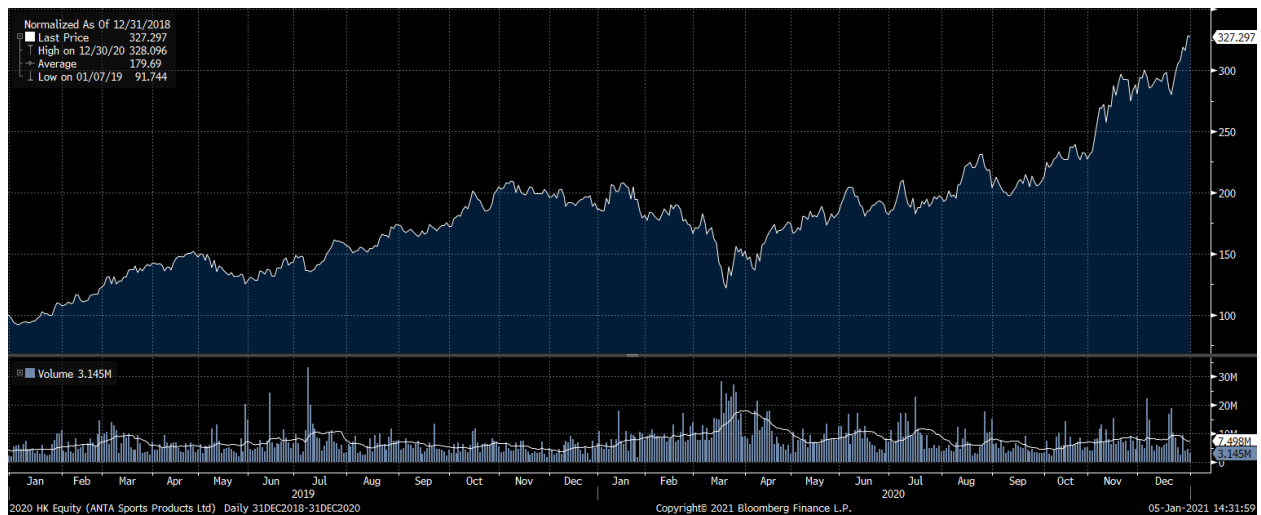
All of this was certainly not an academic curiosity for this house. Anta was at the time our FCL Opportunities fund's largest position, comprising around 12% of our assets. Indeed, when publicly asked which single stock he would hold forever this manager named this specific company³

Behind the scenes we were certainly not standing still. A group of shareholders including this house started a separate, informal and independent group to monitor the company's operations and specifically examine Muddy Waters' allegations. We looked at Anta's suppliers, tried to check the company's shareholders books and some from our monitoring group that were located in China conducted a series of interviews with Anta's retailers. Over the following months after exhaustive research this house concluded that Muddy Water's allegations were completely unfounded.

Over the whole period FCL Capital did not sell a single share of Anta's stock.

³ Stock pickers 21

<https://open.spotify.com/episode/2nj1kFk9QP2hZCrkb5rRQF?si=ldMLjQiGRQaA7rd-8aJAIQ>



Anta's stock performance since 2019

Our patience and cold blood were rewarded. Over the past two years Anta's stock has more than tripled, and the share dive it took on July 7th, 2019 now looks like a tiny blip in the graph.

Of course at the time, on the eye of the hurricane, the episode seemed everything but a tiny blip. As we like to say, we lose our sleep so our investors don't have to. Every Tuesday at 4AM when new reports from our Anta's China monitoring group came we were already awake for at least an hour. It was an eventful time with (for us) a happy ending⁴.

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⁴ And Muddy Waters seems not to give it up easily: recently, Joyy, another of this house's portfolio companies, received a sell rating report from them and again we disagree with their findings. But this will be for another time.

Over the past two centuries the “art” of investing has gradually given place to the “science” of investing.

To state just a few monumental examples of the past century:

When almost everything was randomness, Ben Graham and its disciples, including his most famous protegee, Warren Buffett, showed the world that we should differentiate price (what you pay for a stock) from value (what is the quality of the part ownership of the business you are buying). And so, the value and security analysis revolutions began.

John Bogle showed that markets tend to efficiency and as in any endeavor many will profit from each other’s dreams so for most the most sensible thing is to invest in stock indexes. And so, the passive revolution began.

Howard Marks and Jeremy Grantham showed how cycles and credit affect securities prices and expectations. John Templeton reminded everyone there’s a world out there and the best opportunities are in the least explored places, launching emerging market investing.

As heirs to their geniality we know, as Isaac Newton said referring to the ones who came before him, we are standing on the shoulders of giants. We honor their legacy and their contributions. But the theme of this letter will be the frontiers of investing in the 21st century. Since we walked such a long path in the past two hundred years, what are the still untapped sources of alpha, what are the current frontiers of investing? Where do we go from here?

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We started this letter with the dramatic Anta story because our involvement with that company highlights many of what we call the frontiers of stock investing in the 21st century. For starters, we think one of the biggest sources of edge will lie in the intersection between psychology, especially the study of why humans behave the way they do, how their envy, fear and greedy works and finance. In other words, why do we sometimes feel afraid, what are the times we feel aggressive and so forth.

The eternal fear and greed dichotomy has over centuries given rise to bubbles, manias and stock crashes.

In Anta's case although we let rationality prevail, waited for the facts, did our own research, it is undeniable that like everyone else at some point we probably felt scared.

The key was to prevent that this fear get in the way of sound investing. The easiest thing would be for this house to sell its position and "stop the suffering". But that's part of our job. To suffer sometimes.

We decided from the start that the only thing that would make us sell would be if our own research also concluded Anta was a fraud. Over the past two decades a new and exciting field called "behavioral investing" has emerged with surprising findings that certainly happened since the dawn of markets but only know some astute managers are beginning to learn and use it.

We believe that a second key competitive advantage in investing in the 21st century will be forensics. Once upon a time, some unscrupulous market participants sought "inside information"⁵. In other words, private information that participants should not act upon.

⁵ As well documented in the book "Black Edge"

With the advance of technology, a series of new and amazing ways to extract information are emerging. Satellites monitoring how many ships are carrying iron ore and oil through the oceans and then buying hundreds of millions of dollars of commodities futures based on this information. Big data monitoring how many cars are in a given afternoon across all Walmart's in America. Internet and social media searches. And so much more. As our Anta story shows, a little "field research" still goes a long way. Talking with suppliers, customers, competitors and investors is an art where due diligence still rewards investors willing to do their homework.



Satellites Monitoring - A new way to find an edge

A third 21st century source of alpha will be applied accounting. The world has never had so many smart investors, CFAs, analysts and CEOs. Accounting has always had a bad reputation seen as boring and futile, but its knowledge has always been a very valuable tool for investors, with Warren Buffett claiming as far back as 30 years ago that investors should learn “all the accounting they can”.

Some smart investors are getting better at the art of putting together their business analysis with accounting by, for instance, noticing when a company has an Income Statement that just doesn't "match" with their cash flow, which is usually a sign that something is plainly wrong.

To give an amazing example, John Hempton, Chief Investment Officer of Sydney based Bronte Capital shorted the stock of a company called Autonomy, concluding it was a fraud because after careful analysis and comparison between the company's income statements and cash flows he realized the numbers had to be overstated.⁶

As for the final two alpha frontiers (in this non exhaustive list) in this voyage to explore the unexplored and boldly go where no investor has gone, we will mention two more macro fields: the study of factors and asset arbitrage

If there was ever one particular illustrative day of how the emerging field of factors and their respective ETFs work, look no further, dear investor, than November 9th, 2020. It was the day when Pfizer announced to the world they had after all developed a Coronavirus vaccine and it was nearly 100% effective.

Over the following hours an amazing and fascinating dance took over global finance in what was certainly one of the most interesting days of our careers. All of a sudden, the most decimated companies by the global epidemic: cruises, airlines, touristic operators and theme parks, saw their stocks skyrocket, while the pandemic "winners", such as Zoom, tech companies in general and defensive stocks saw their stocks sink.

It was a major rotation if ever there was one.

⁶ <https://www.businessinsider.com/heres-how-i-knew-autonomy-was-a-fraud-2012-11>

Over the past few decades, a new financial instrument called ETF (exchange traded fund) was born. At first, they had a very straightforward theme – say, a France ETF replicating the French CAC index, or a Technology ETF replicating the Nasdaq. But over time they got more diverse and sophisticated. Nowadays investors can have exposure to any specific factor: uranium prices, value stocks, indebted companies and so forth. The idea is to own an ETF with a respective basket of companies that share a common characteristic without incurring too much specific company risk. To use a culinary metaphor, it is like we can have a nutrient without having the specific food. The protein without breaking the egg.

Over the 21st century this house thinks the story of factors will help investors uncover new and amazing investment ideas. All of this is great news for stock pickers and long-term security holders like us.

Finally, and this might be the most polemic one, we believe asset arbitrage might be a future source of alpha. What do we mean by that? Over the past 50 years the institutionalization of asset management put the managers in boxes: stock picking, fixed income, merger arbitrage... and this has served the industry well. But one “blind spot” is that not many investors nowadays can see the whole. And this is far away from the original institutional investors like the 1950s Buffett partnership or George Soros’ Quantum Fund.

Of course, no one is saying we are going full circle back to those days, however the ability to see across asset classes, compare them, “see the forest, not the trees” is one ability not very often seen in finance nowadays.

Certainly, apart from this five there are many others. Almost daily this house witnesses amazing new investment ideas and talented managers in this eternal factory of dreams and ambitious people that is global finance. As we said before⁷ there has never been a

⁷ October 2017 FCL Letter

more exciting time to be an investor. New countries, new ideas, new companies with amazing entrepreneurs. It's going to be an interesting century. Let's start to explore.

The Frontiers	
Behavioral Investing	Study of why we behave the way we do when investing
Forensics	The ability to get legal non-public information about a company
Applied Accounting	Going from financial statements to real business model
Factors	The study of what "ingredients" investors will get
Asset Arbitrage	Comparing asset classes and their harmonic composition

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Thesis: Entain

Remains of an anti-tech portfolio

“What is understood needs not be discussed”

(Aldous Huxley)

This house is currently very publicly anti-tech. Over the past year we increasingly got more vocal about what we think are increasingly out of reality valuations of some very prominent US big tech companies.

Since we are no fans of predictability, this quarter's thesis, dear investor, will feature of all things, a tech company. But how did we get involved with this amazing company?

First of all, this specific thesis in no way changes our overall opinion about tech valuation in general and the Nasdaq in particular. We think many businesses there are trading at dangerous valuations, leaving little margin for error.

That being said, our permanent search for out of the box ideas got us wondering if there was something left in techland for us after years of involvement with Match Group and the Chinese trio we still have in our portfolio (Vipshop, YY and Trip)

Entain is one of the global leaders in online sport-betting and gaming. Although it is legally a British company trading on the London Stock Exchange, it operates in more than 20 countries.

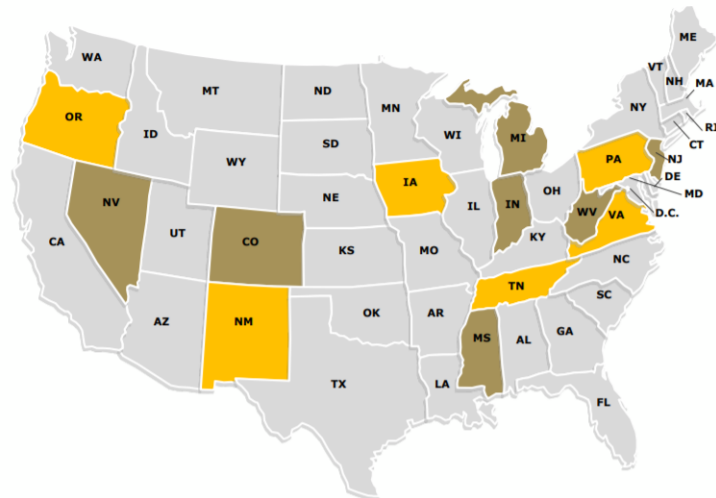
It has several valuable brands, like Sportingbet, Btwin and the British betting store chain Ladbrokes.

One interesting comparison emerges with Uber: just like when that amazing Silicon Valley app started what, at the time, could be considered a “gray” market (not yet regulated although not completely illegal), likewise sporting bet over the past decade has been evolving from a “gray” to “legal” industry.

A few big prizes remain: Gradually, the largest prize, the USA, has been adopting a more regulation friendly policy. A total of 13 US states have already legalized online gambling and nine more are in the process of doing so.

BETMGM IS LIVE IN 7 STATES WITH FURTHER LAUNCHES BY MID-2021

Market	Retail Sports	Online Sports	iGaming
NJ	●	●	●
MS	●	●	●
WV	●	●	H2-20
NV	●	●	●
IN	●	●	●
MI	●	H2-20	H2-20
CO	On hold	●	●
NM	H2-20	●	●
PA	●	●	H2-20
OR	H2-20	●	●
TN	●	H2-20	●
IA	●	H1-21	●
VA	●	H1-21	●



Legend: ● Live ● Launching ● Unregulated

Note: Current BetMGM estimates on launch periods

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Many US States have already or are in the process of legalizing online gambling

In 2018 Entain, then known as GVC, entered a joint venture with MGM, the famous Las Vegas strip operator, in a 50-50 partnership that relied on MGM's brand and US expertise and Entain's tech know how to dispute the US online market.

The enterprise is still in its early innings but already showing a lot of promise in this nascent and world changing market.




A few additional prizes will be seen further. The Brazilian congress has over the years hold on and off discussions about regulating online gambling as have many other countries.

In Europe, the movement towards regulation seems unstoppable.

The big picture consequence is that while Entain still trades at multiples seen in uncertain and gray area companies, it is increasingly a super formal, stable and fast-growing business while the market seems a bit lost and distracted about the transition.

In 2019, 97% of Entain's revenues were already in regulated markets (with Portugal being the latest market to formally legalize online betting) and the company took the strategic decision to bring this to 100% until 2022.

NEW MARKET OPPORTUNITIES

AFRICA 	POPULATION: c.850m GDP: c.€1.6trn POTENTIAL GGR: >\$10bn	<ul style="list-style-type: none"> • Recreational market • Emerging technology • 20 regulated markets
LATIN AMERICA 	POPULATION: c.300m GDP: c.\$2.7trn POTENTIAL GGR: >\$25bn	<ul style="list-style-type: none"> • Bwin brand recognition through football • Foothold through Brazil & now Colombia • SportingBet #1 brand in Brazil
EUROPE 	POPULATION: c.160m GDP: c.€1.8trn POTENTIAL GGR: >\$12bn	<ul style="list-style-type: none"> • Bet.pt acquisition agreed • Organic opportunities for bwin & Party brands • Further M&A opportunities

1. Source: H2GC 2019 Global Online GGR

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New markets for Entain to explore

Looking further out ahead as this house loves to do, we see online gambling as a clear 21st century winner. Over the past few decades, especially with the advent of the technology revolution, for better or worse, people's attention spans have shortened. Not many of us nowadays are willing or capable of spending hours immersed in books, for example. This is the age of instant gratification, of superficiality.

When it comes to game watching, this house thinks a long-term trend might be a decrease in complete engagement of fans watching continuously a match (or race, or fight) and increase in constant chatting, instant betting, gaming and simultaneously watching). In other words, a greater percentage of those watching, say, a Premier League soccer match will be casually watching while at the same time placing bets in their smartphones to increase the fun, chatting with their friends etc. This is, we think, how sports watching will evolve in the 21st century.

The central point of our thesis is that we think online betting will be a beneficiary of people's short attention span and constant need of stimulation.

So why does this opportunity arise? This house thinks of many reasons. First, it is a British company with Russian roots, while conventional wisdom is used of thinking about promising tech companies and as American, especially Californian, endeavor.

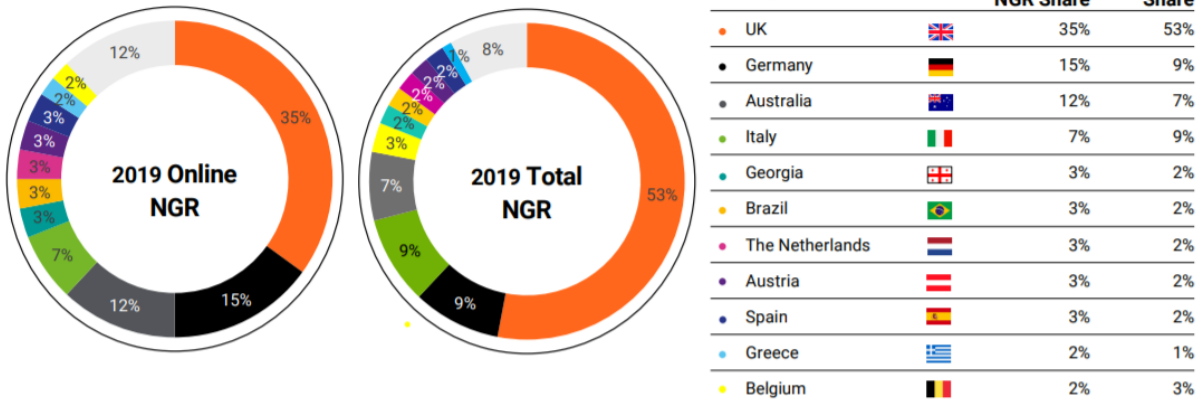
Furthermore, Entain was, until recently, a company that had a significant portion of its revenues in "gray" not yet regulated markets. It is reasonable to assume its multiples should reflect this uncertainty. Although certainly this logic doesn't seem to apply to Nasdaq companies.

The fact is we are now entering the era of complete legalization and regulation and we think 21st century online gaming champions will emerge from this space.

Online betting might very well be the last unexplored corner of opportunities for tech companies in the smartphone era. After so many social networking, software and productivity ideas, online betting was a latecomer because it deals with a more complex set of social and legal circumstances, but its growth trajectory might be extraordinary.

GEOGRAPHIC DIVERSIFICATION

Highly diversified global operator with >65% of Online NGR non-UK



Entain is more geographically diverse than its peers

Of course, being a European company in a still underpenetrated industry, Entain doesn't melt hearts like, say, a FAANG stock. Likewise, it certainly doesn't trade at 60x revenues like some Nasdaq recent IPOs or tech darlings from California, in these "totally normal and non-distorted" markets we are witnessing currently.

Even inside the niche of online betting, investor distraction, hype and geographical arbitrage seem to be in full rage: In April 2020, a Boston based online fantasy games company called DraftKings, the leader in the nascent US online betting industry, went public via a blank check company. After a meteoric rise over the past few months, DraftKings has currently a market cap north of \$20 billion valuing the company at around 25 times next year estimated revenues (no profits since the company doesn't expect to turn a profit soon).

It is not in the scope of this thesis to argue that DraftKings is not a promising company. It certainly has the strongest brand among the US based sport betting players and it probably has strong growth ahead.



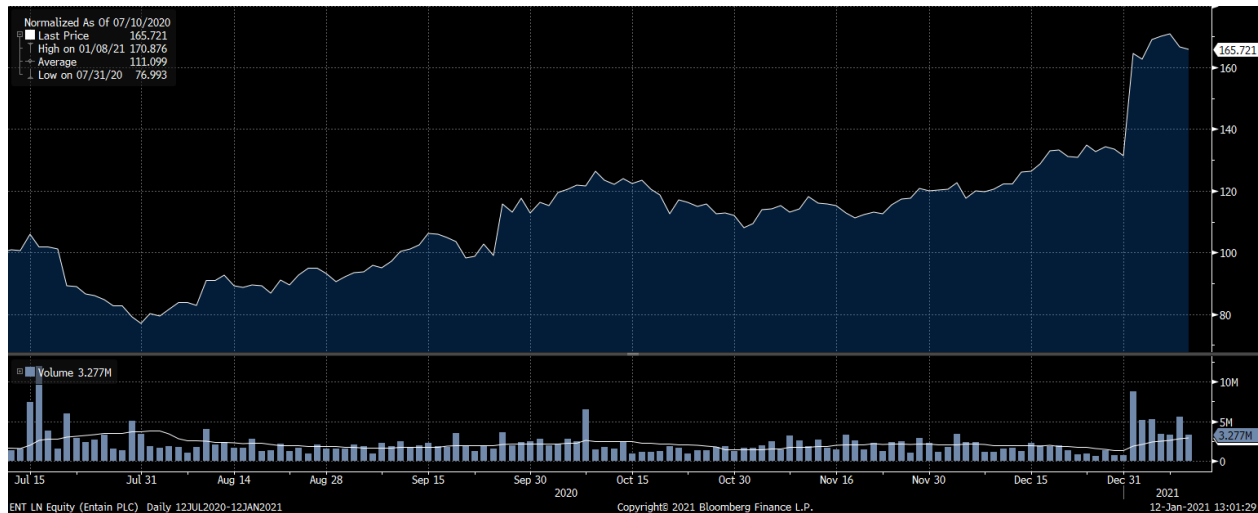
To show how ebullient the sector is right now, FanDuel, another of the players who will contest the US market saw a \$4.2 billion stake acquisition by a Dublin based company called Flutter Entertainment, which was already a FanDuel shareholder. FanDuel's multiples acquisition in this transaction were arguably even higher than DraftKings' valuation.

Company	Price to sales multiple (2021 consensus)
DraftKings	25
Flutter (whole company)	5,5
Entain (whole company)	2,3

And when we thought that this was already a heavy news flow, it turns out that in the first trading day of 2021 rumor on the street was that MGM, Entain's partner in the 50-50 BETMGM joint venture, is making a bid for Entain to take the company private.

At the time we write this letter (January 2021), details are still gradually being made public. But according to several international news sources, Barry Diller, IAC's shareholder, might inject \$1 billion in MGM to help the bid with this cash infusion. Sequentially becoming one of MGM's largest shareholders in a new, more digital era.

This house knows Barry Diller for a long time and has deep regard for him. He was, after all, Match group's controlling shareholder in all the years the Nasdaq listed online relationship group was our largest holding. If our Match years will serve as a guide, we should expect tough terms which we might as well disagree with but also amazing vision ahead once we are all on the same boat.



Entain share price, past 6 months

The market's reaction was, predictably, fast and excited. But we agree with the company's management that the offer still significantly undervalues the company.

We think a more reasonable valuation for Entain would be:

- a 10x revenues multiple on its promising online operation that is the largest piece of the company
- a 15x earnings multiple on its British retail operation.

It is hard to come with an exact multiple since Entain doesn't disclose Ladbrokes earnings separately, but we think something between 3,000 and 3,200 pound per share would be a fairer offer. We don't think MGM will get close to these numbers so would vote as shareholders for the company just to continue in its own growth journey, entering

new markets, developing new products and technologies and being an overlooked tech leader of the 21st century.

However, the company does face risks: its US brand is not the strongest one, it still faces legal risks and its managements faces uncomfortable turnover levels. But Entain has the best in class technology infrastructure to be a significant player in this promising market. We feel comfortable seated in a win-win situation. Either a higher bid offer or the chance to continue as shareholders in this fascinating and promising business.

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Performance

FCL Opportunities	
2020, in BRL	45,30%
2020, in USD	12,45%
MSCI All Country Index, 2020, in USD	14,47%
Since Inception (30/01/2017), in BRL	173,23%
Since Inception (30/01/2017), in USD	63,96%
Avg Annual Return, since inception, in BRL	29,18%
Avg Annual Return, since inception, in USD	13,43%

FCL Hedge	
2020, in BRL	11,52%
2020, as % of CDI	418,91%
Since Inception (01/02/2017), in BRL	38,47%
Since Inception (01/02/2017), as % of CDI	147,56%

This past year was certainly the most successful and most important so far for this house. FCL Opportunities, our flagship fund, appreciated 45,30% in BRL and 12.45% in USD during 2020. More importantly, since our inception on January 30th, 2017, we hold an average annual performance of 29,18% in Brazilian real and 13,43% in USD.

In 2020 we hold special pride because our performance happened despite two important and often overlooked headwinds:

- a) Except for the Nasdaq, most major stock indexes worldwide didn't experience a significant appreciation in dollar terms in 2020. Regardless of this, our fund delivered a robust performance through specific investment ideas.

Stock Returns in 2020 (in USD terms)	
MSCI All Country Index	14,47%
Nasdaq	43,64%
S&P500	16,26%
FTSE100	-11,84%
CAC40	1,09%
Hang Seng Index	-2,96%
CSI300	35,71%
Ibovespa	-20,08%

- b) This past year saw the US Dollar close to all-time highs against most of its peers, especially in the first semester. While, as a global long term investment partnership, it is easily appreciated by our investors that when the Brazilian Real falls in value against global currencies our returns will, in their eyes, when measured in BRL, outperform. What many don't notice is that since we hold a basket of investment ideas dispersed geographically, with an emphasis in emerging markets and BRIC countries, we have exposure to several currencies like the Euro, the Chinese Renminbi, the US Dollar and the Brazilian Real. Therefore, it is also true that in times when the US currency outperforms everyone else, such as periods of stress like the Covid Crisis, our fund shares will likely underperform in US dollar terms, since our invested companies are

dispersed geographically and don't all book their revenues in US dollars. In other words, our portfolio is NOT a dollar play.



US Dollar index, past 10 years

Having said that, we feel extremely encouraged by our performance this past year and our annualized returns so far (which is this house's most important internal assessment metric). Over the next few years we expect, like most financial analysts, a gradual reversion to the mean in the value of the US dollar, which should provide an additional tailwind for our fund's performance, when measured in US dollars.

At the end of the year, FCL opportunities top 5 positions, were:

Position	Country	% Fund NAV
Capri Holdings	USA	12,30%
Vipshop	China	10,29%
Anta	China	9,31%
Entain	UK	9,10%
YY	China	8,78%

As for FCL Hedge, the portfolio composition in December 31st, 2020 was:

FCL Hedge	
Stocks and ETFs	71,26%
Cash and Fixed Income	15,50%
Other Positions	13,24%

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Next quarter we are going to celebrate four years of our Opportunities fund. All in all we feel we are only scratching the surface of the amazing global opportunities we can encounter in the 21st century. The journey will surely bring scary and unpredictable moments but also the chance to witness the development of incredible technologies and businesses that will define the century.

From Chinese school dropouts that funded multibillion dollar companies and list them on the Hong Kong Stock market⁸; to daring Brazilian entrepreneurs that, unhappy with the country's bureaucratic banking system, found daring tech companies eager to overthrow the banking oligopoly in South America's largest economy⁹; to European fashion houses maintaining throughout the centuries their brands and traditions and now introduce them to a new generation of Asian consumers; to the eternal dream factory that is the US economy from which we temporarily parted ways last year, but to which we will certainly be back; not to mention interesting opportunities in other, still untapped places, like (to some extent) India, Vietnam, Australia and Southeast Asia. We are confident that all of this is just the beginning. We are only scratching the surface and hope our next harvest of Opportunities will be even more amazing and inspiring than the last.

⁸ <https://www.scmp.com/business/markets/article/3100606/chinese-bottled-water-giant-nongfu-spring-rises-71-cent-trading>

⁹ <https://contxto.com/en/brazil/neon-fintech-micro-entrepreneurs/>

Over this past year our company has roughly doubled in size and number of investors. To some of you who found out about our fund and our house through the circulation of our quarterly letters, through our internet webcasts and presentations, through investment platforms or any other mean, although we have not yet physically met, you are most welcome.

We invite our new investors to join us in this unique ride and suggest our website, especially this house's investment letters, that go back all the way to August 2012, are the best way to understand our unique investment philosophy and see if it is a fit for you. Be prepared for an unconventional, global and unorthodox mindset, and be warned that an open mind might be a necessity. But our guess is that since you've come this far in our letter, you're probably not interested in super conventional investment products in the first place. So, you might be in the right place.

To each one of you thank you very much for your continuous support and trust. Welcome to our global Opportunities journey.