

FCL*Capital*

3Q 2020

1- In search of excellence

“Be a yardstick of quality. Some people aren't used to an environment where excellence is expected.”

(Steve Jobs)

Legend has it that to show how exciting this new technology his company was developing was, Thomas Watson, then IBM CEO, said those not exactly prescient words back in 1943:

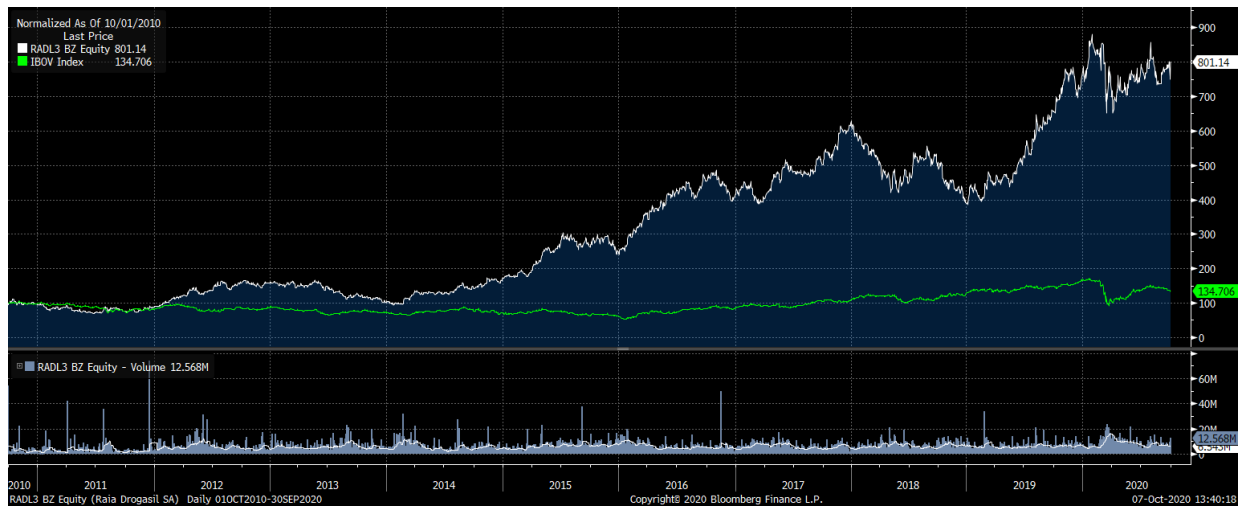
“I think there might be a market for maybe five computers in the world”.

The beauty of this prediction is that, to this house, it carries an amazing resemblance to sell side reports of then recently listed Microsoft (back in 1986) or Amazon (back in 1997).

In both cases there were even buy ratings for the companies when they first sold their shares to the public. Just like Watson, the analysts were bullish! In Microsoft's case, after the company's IPO back in 1986, an analyst that gave a buy rating also put the company with a target price 17% higher than the price Microsoft was then trading. Over the next decade or so Microsoft would multiply its stock price by roughly a thousand times. Needless to say, analysts would switch back and forth between “buy” ratings, to “maintain” to, occasionally, “sell” ratings. And as this spectacle progressed, the company would continue to defy the odds like a miracle, bringing the windows revolution to the masses.

In Google's case, in 2004 a few months after its listing, The Economist magazine declared that Google's shares were “ridiculously” priced. And to publicly admit a mistake, this house has for years admired RaiaDrogasil, Brazil's largest pharmacy store

chain. For over a decade we were convinced we liked everything about the company: its sector, its prospects, its management, its culture, its optionalities. But still to this day we have never invested a single cent in the company, concluding that it was “too expensive”. Over the past decade RaiaDrogasil was the top performing stock in the Brazilian stock exchange and this house missed the boat, deciding to sit out.



Raia Drogasil vs Ibovespa, past 10 years

This house’s main fund is called Opportunities. Why the name? Because we like to think of it as a vehicle to hunt for the outstanding ideas. The biggest financial promises of the century. The future. The supernovas. In other words, we look for excellence and try to find it in overlooked corners.

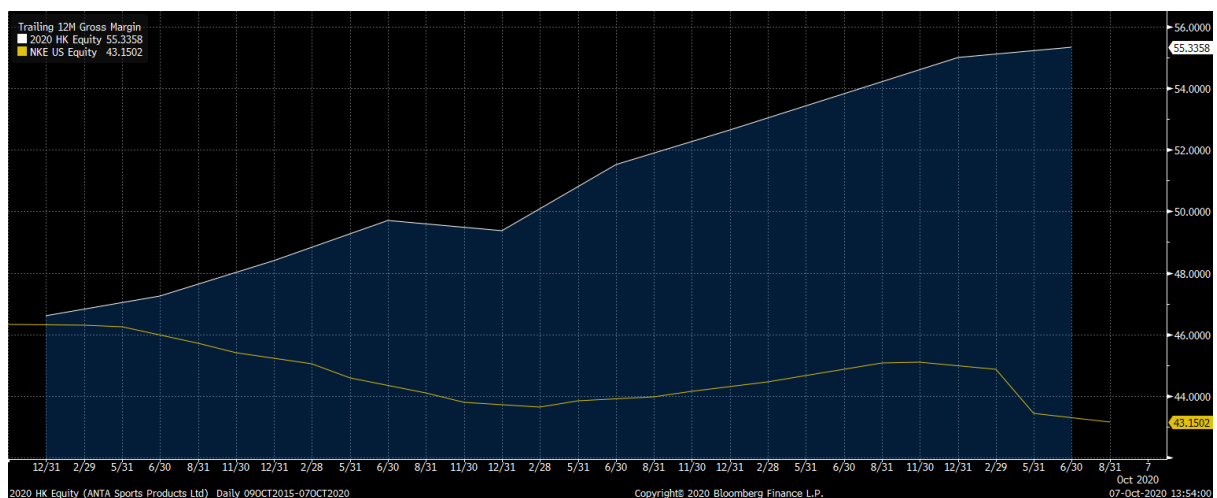
And excellence, dear investor, is just like a supernova. It is very hard to find. It is, to use a Malcolm Gladwell’s term, an Outlier.

In our previous letter we discussed our permanent quest to try to predict the future. One of our tricks, we wrote, is to use a technique borrowed from Phillip Tetlock’s book Superforecasters: start with a base rate and try to adjust your predictions from there.

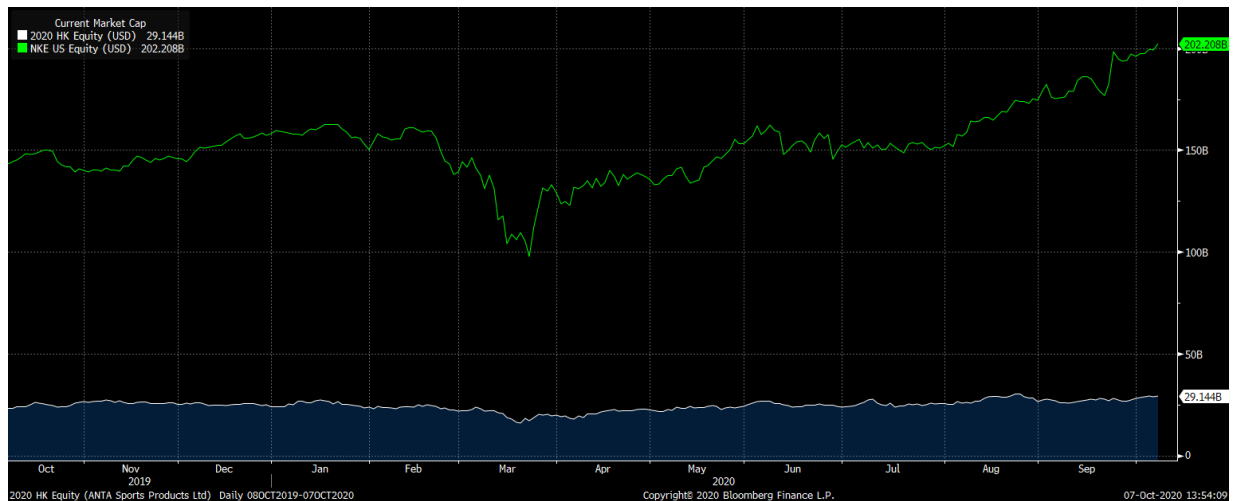
This letter is going to be about our search for excellence. About the outliers that make Tetlock's base rates seem foolish. The few companies, ideas and management teams that defy expectations and our quest to spot them.

Back in 1994 in a still liberating China, a man named Ding Shizhong decided to build sneakers and shoes from the back of his home with some borrowed materials, first to sell to some friends (since almost no one in China had money to buy Nike's shoes back then) and gradually to the general public. He was convinced he could make shoes that were as good as Nike's for half the price.

Today his company, Anta, is a top 3 position in our fund since 2018. Anta would go from doing cheap copies of American and European shoes to being the buyer and owner of major western brands like Wilson tennis rackets and Arcteryx cycling clothes. More importantly, we think, while the world is unanimous in recognizing the genius of Phillip Knight and his creation most of the world still has to realize the excellence that we think is present in Anta. One of the first lessons in investing, after all, is that to beat the market you have to deviate from consensus. In this case, it is not enough to spot excellence where everyone already knows excellence is present, like, say, Apple or LVMH, but to be among the first to notice it in a new place.



Anta (blue) vs Nike, trailing 12 months gross margin



Anta (blue) vs Nike, Market cap

Half the world away in the city of Milan, Italy, a businessman named Remo Ruffini bought in 2004 a long-forgotten clothing brand called Moncler.

The logic of luxury fashion brands was becoming more and more adverse to standalone midsized companies like Moncler: huge conglomerates like LVMH (owner of Louis Vuitton, Moët Chandon and countless other luxury brands) and Kering (owner of Gucci and much more) were progressively displacing the competition with synergies and scale. At the same time, the country of Italy was going through a severe long-term economic decline, unable to thrive and be competitive inside the eurozone, a problem still not completely solved.

Ruffini's idea was to turn Moncler into a winter outdoor luxury clothing brand. Over the following 15 years, Moncler was not only able to thrive by itself without being part of one of fashion's huge conglomerates, but it turned its CEO into a dollar billionaire and multiplied its sales by 20 times since acquisition. It even outperformed the world's most formidable luxury conglomerate since it was listed in Milan's stock exchange in 2014.



Moncler (green) vs LVMH (Blue) since Moncler's listing in 2014

So how do we approach our permanent search for excellence? We think an outstanding and not yet discovered company usually has two different ingredients: a unique founder of executive team and a unique opportunity.

Excellence ingredient 1: the people

It is hard to spot a visionary before all the world realizes his greatness. In this letter this house mentioned Remo Ruffini, Ding Shizhong and could easily have discussed countless others outstanding business leaders. If there's one thing we think unites all of those people that come from different cultures and speak different languages it would probably be a clear sense of purpose about a specific missing link, a clear mission to make the world better by doing something specifically that no one else is doing. In other words, the truly legendary entrepreneurs, the Sam Waltons or Steve Jobs of the world are the people the planet relies on to make it better, to correct a lack of something that is still missing.

To this house this is a first step to spot a great entrepreneur and a great company. If you are able to notice a missing link, you might be on to something, as this is the real founding stone for everything, even for a great organization with a thriving culture.

As examples of this sense of mission that gave birth to unique entrepreneurs we would mention: Remo Ruffini and the idea of a luxury winter clothing brand with a Made in Italy appeal, Ding Shizhong and his idea to unite manufacturing excellence and marketing , Steve Jobs and the idea that computer machines should be sexy, approachable things, John Mackey and the idea of an upmarket, healthy and ethical and conscious supermarket in Whole Foods, and a lot more.

Excellence ingredient 2: the opportunity

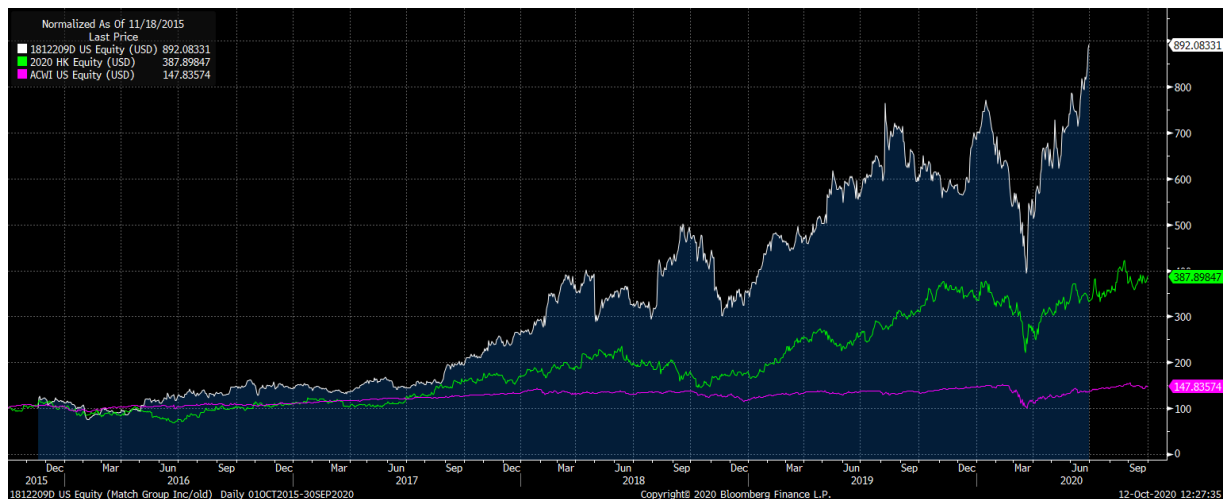
As shown in Gladwell's book Outliers, excellence never exists in a vacuum. Excellence always comes to light due to specific circumstances in a specific time and place. Bill Gates had the luck and luxury to be one of the first high school kids in the USA to have a personal computer in his school. Remo Ruffini was a wealthy businessman who could only use the Italian appeal because, well, he was an Italian fashion executive. This is not to deny or subtract of those founder's greatness. To the contrary, it is only a realization that greatness happens inside specific circumstances.

In the case of our excellence hunt, we know it will be very hard to find excellence in some corners of the market while some other promising and unexplored areas might be giant nurseries of greatness.

Above all this house's quest to find excellence is also a realization of our changing journey as stock pickers: over the years we gradually felt that our task is becoming less and less quantitative - about numbers spreadsheets and terminals- and more and more qualitative-about the stories that shape companies and the people behind them.

It is also an admission of failure: the vast majority of our mistakes over the years were investments in companies we knew were of subpar quality but the multiples were just too irresistible, too cheap to let them pass-while our two largest home runs- the two investment ideas that combined comprise over a third of FCL Opportunities profits since its inception in January 2017- are Match Group and Anta.

Both felt uncomfortable at first- this house knew they were amazing companies that were still uncovered and unloved by global investors- but they still had higher multiples than the ones we were previously more used to paying when making investments for our funds. Thankfully for our investors we were able in these cases to spot greatness and how amazing entrepreneurs and business stories would eventually become so much more important than difference in opinions about the exact percentage of how overvalued or undervalued their multiples were.



Match Group (blue), Anta (green), MSCI ALL Country Index (purple) past 5 years in USD

So what areas is this house focusing on right now? As our long time readers and investors know, we think that over the past couple of years, one of the planet's greatest reservoirs of excellence, the amazing companies of Silicon Valley, was nearly fully exploited. It is beyond the scope of this quarterly letter to analyze the interactions between monetary and fiscal policy, global investors mania and stories and the Nasdaq stock index current high multiples but suffice to say we don't generally see a lot of value in the Nasdaq anymore. Our attention lately has been diverted to consumption in Asia, tech and new business models in China, specific long term structural winners in Brazil like education (Yduqs) and healthcare (Fleury) and European brands and luxury houses like Moncler. For more about Moncler the next section discusses the thesis in depth

For the future that are many stones this house has not yet turned, many corners we think might be promising. Among them we would mention possible future opportunities in Asian income rise and consumption upgrade, that might be captured not only by Asian but also European companies, companies in the emerging Crypto/Fintech/Alt Coins space, and the global tendency of everything-as-a-service (transportation with Uber and its competitors, Housing and the upcoming Airbnb IPO, even relationships and the arrangements websites that make us think that our involvement with Match Group might not be this house's sole incursion in the area, entertainment of all kinds from videogames to video streaming and a lot more).

We are certain the next few years will bring many fresh business models and investments ideas to our attention and we hope to be able to notice excellence when we see it. The only certain thing is that we will continue to explore and search like gold miners for this rare element, the supernova of excellence.

2-Thesis: Moncler

This house is convinced that the European luxury sector in general and Moncler in particular are an outstanding investment opportunity.

Part 1: Why luxury?

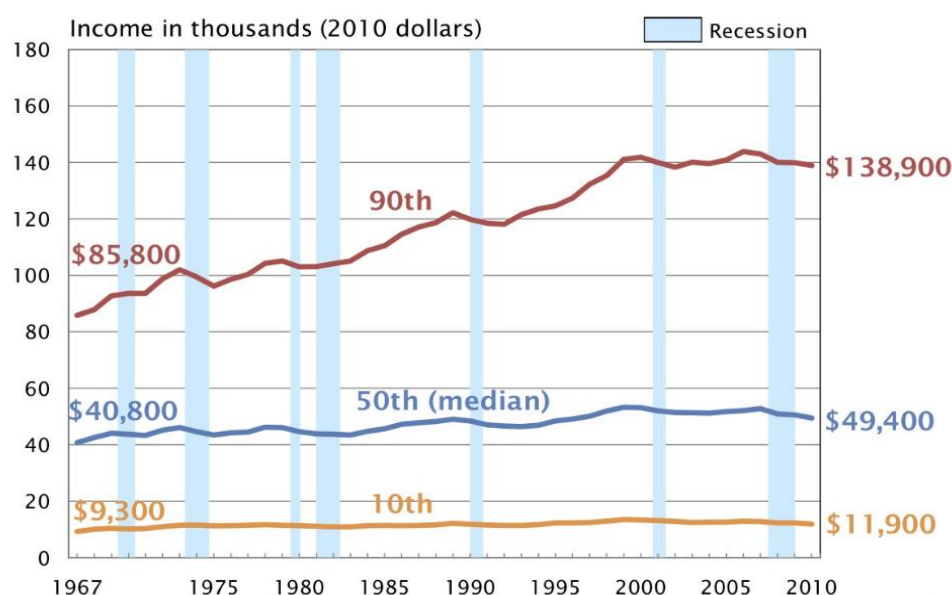
So why do we think the luxury sector, that has been around for so long, holds so much promise?

There is a confluence of factors, but first and foremost, the world is becoming a more unequal place. There is massive academic evidence^{1,2} that more unequal societies are more prone to luxury spending. Why is that so? Because luxury spending, be it BMW cars, Michelin starred restaurants, Louis Vitton handbags and everything else, is to a large extent about signalization. In an era of extreme differences, one feels the

need to make a statement: to communicate where you are in the social ladder. To prove the point: Brazil and South Africa, two middle income countries with significant wealth concentration are important markets for luxury goods while much wealthier Scandinavia, home of super affluent but relatively egalitarian societies, is an afterthought for the Louboutins and Armanis of the world.

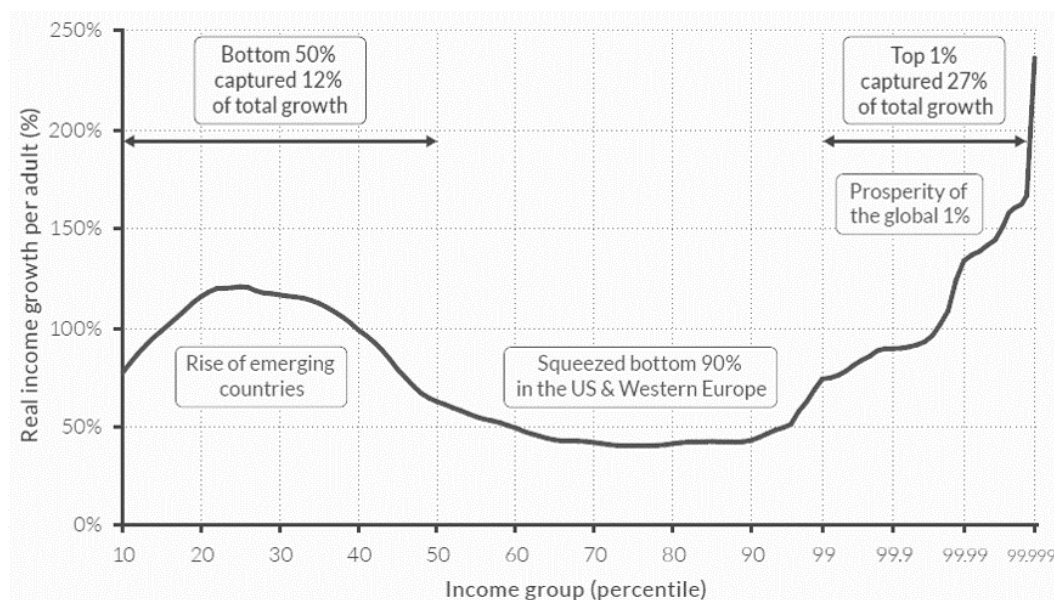
Of course, apart from inequality, luxury spending also thrives with rising incomes. To sum it up, the more affluent a society becomes and the more concentration of wealth it experiences, the more fertile ground for luxury houses.

Real Household Income at Selected Percentiles: 1967 to 2010

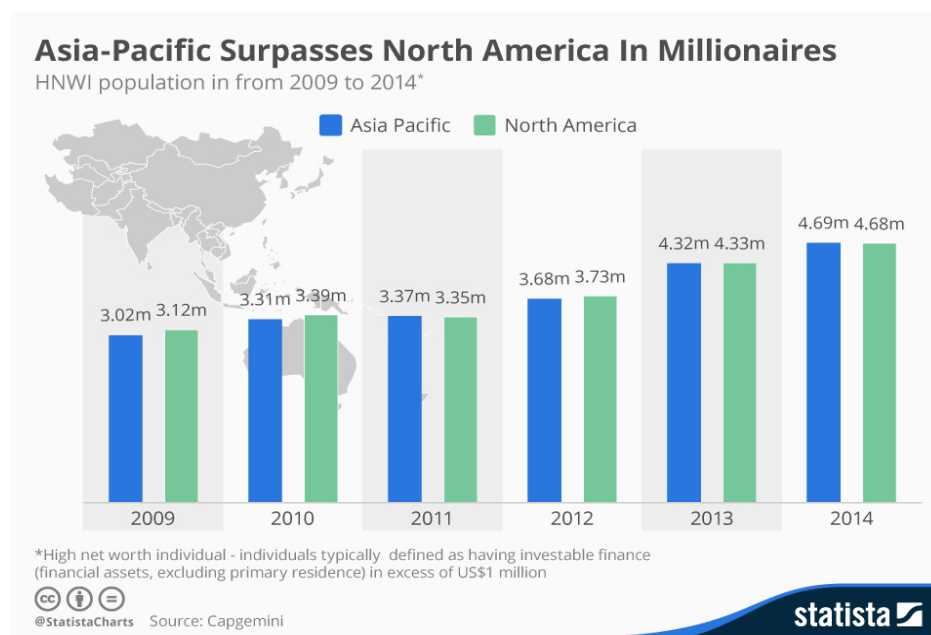


¹<https://www.newstatesman.com/politics/economy/2019/12/our-era-inequality-luxury-capitalism-thriving>

²<https://www.forbes.com/sites/peterubel/2017/02/28/do-luxury-brands-benefit-from-income-inequality/#1df67a9327b5>



The thing is the whole planet is becoming more affluent and with more wealth concentration. For the first factor, growing affluence, China and, to a lesser extent, India and the rest of Asia's rise, will certainly give birth to a huge number of new dollar millionaires willing to show their wealth.



As for inequality, it is well known that the most important market of the 21st century, China, is gradually showing dizzying signs of wealth concentration.

According to some estimates, if we add up purchases made inside its national borders with items bought in trips abroad, especially to Hong Kong (which we will consider “abroad” for the purpose of this thesis) and Europe, China might already make around a third of global luxury spending and this share will certainly rise over the next few decades.

Hong Kong is probably already the most important city for global luxury spending, from rare wines to expensive jewelry and Asia as a whole will certainly be the core market for almost all luxury companies.

Since most luxury houses are European, some of them still trade at “European multiples”, in other words, with analysts projecting stable but single digit perpetual growth.

This house thinks nothing could be further from the truth in the 21st century dominated by Asia consumption.

Luxury will be a thriving growth sector, driven by a new class of millionaires in unequal societies. And what is more, thanks to its brands moats we think huge winners are still available for the taking in the sector for careful investors.

Why Europe?

So why European brands? Although the US was clearly the major winner in the past few decades with tech companies from California and Seattle dominating the planet, at least in one particular area the Europeans never lost their leadership: they are the arbiters of good taste, beauty and elegance for the rest of the world, including the Americans but even more importantly, also to the rising Asians.

From San Pellegrino water to wines to Hermes handbags to German cars and countless other items and brands, it is to Europe that the planet has always turned to when evaluating luxury.

A quick exercise would be to compare a basket of European and American luxury companies over the past 10 years. The performance, we think, speaks for itself.



Moncler (blue), LVMH (green), Ralph Lauren (purple), Macy's (red) part 5 years

Finally, luxury spending is one of the least affected parts of retail when it comes to online disruption. For frequent and commodity-like purchases like books, Amazon will easily crush you. If on the other hand you feel like spending \$ 10.000 on a Birkin bag, a 30 minute trip to the Hermes store is not only worth it: it will make the whole experience more pleasurable.

To sum it up, we are convinced that luxury spending will experience a new age of fast growth thanks to rising Asia consumption, growing inequality and that European brands will disproportionally benefit from it.

Why Moncler?

Since this house is bullish on European luxury, why do we think Moncler might be one of the most valuable fashion brands in the world and maybe the most promising global luxury opportunity?

Management, as always, goes a long way to explain our choice. Remo Ruffini is one of the most astute European CEOs alive and not just in luxury. From an underperforming brand when he bought control back in 2005, he and his team were able to multiply sales by some 20 times, profits by even more and even more importantly to make Moncler an item of desire and passion. For many winter enthusiasts its coats and jackets are the ultimate sign of elegance.

Moncler also benefits from several secular tendencies; it is no secret that global fashion is becoming more outdoor oriented (clothes that are made to be worn in sports activities are outperforming clothes that are made for an office environment, especially in a work at home world, the so called “athleisure” phenomenon) , less logo driven (the age of huge monograms is gone as they are now seen as blasé) , and younger, less pretentious. Moncler outperforms virtually every other fashion house in all of those above-mentioned items. Not coincidentally, with its strong management team and perfect product market fit, Moncler has been one of the fastest growing luxury brands in the world. In other words, Moncler is a brand for its time.

Over the past years Moncler's sales almost double, against a 20% rise for LVMH. Still, the global luxury leader trades at some 15 times 2022 Ebitda Multiples , against 12 times for Moncler. Just a similar multiple level, which we still think would seem cheap given the stronger growth profile, would mean a 25% upside. But we actually look to much more than that. We hope to have found a long-term compounder and secular winner in a growing and consolidating industry.

Finally, there is a specific dynamic inside global luxury fashion industry that is an important part of our thesis. Over the past decade, most standalone fashion houses , especially Italian ones, like Ferragamo and Versace (that although still items of desire, did not have the shared resources and financial firepower to face the competition) have suffered, while huge conglomerates, especially LVMH, owner of Louis Vitton, Moët Chandon , Fendi and hundreds of other brands and Kering thrived.

In other words, in luxury, as opposite in almost anywhere else in finance, there is a conglomerate premium and not discount. Luxury conglomerates, especially the two huge French ones, are seen with good eyes since they have portfolios of brands some of them outperforming while they use their ample resources to hire talent and spend on marketing.

While there is strong evidence that the financial community is on to something (the suffering of traditional Italian brands that were family owned being one indication) we think that in the particular case of Moncler the market is making a mistake. The company is growing fast and fastly approaching escape velocity: now Moncler already has something close to the necessary scale to remain alone. Because it is already big enough, important enough, and promising enough to not need to be part of a conglomerate.

Not coincidentally, earlier this year Kering, one of the two huge French conglomerates approached Moncler with a takeover offer that was refuted by Ruffini and the company's shareholders. The market reaction, which would usually be chaos in circumstances like this was an almost complete shrug: the stock is outperforming the Italian index this year.

Over time we think Moncler's discount to the two huge luxury conglomerates will become a premium: Moncler's is growing faster and has more growth avenues, with its sales in Asia still less than 40% of the company's total. We think in ten years this share might rise to close to 75% of the company's sales and even more of its cash generation.

Meanwhile the company is guided by a genius CEO with outstanding talent for execution that, this house thinks, will guide Moncler through a future where it will deal with many interesting trends like fast fashion, Asia's rise, outdoor wear and a lot more. The only constant aspect might be the power of its brands, unique in its niche of alpine sports, and the desire and loyalty it provokes in its consumers.

3 – Performance

FCL Opportunities	
Year to date, 2020, USD	-14,70%
Year to date, 2020, in BRL	19,56%
MSCI ALL Country Index YTD, 2020	0,60%
Since Inception (30/01/2017), USD	23,41%
Since Inception (30/01/2017), BRL	124,84%
Avg annual Return, Since inception, USD	6,11%
Avg annual Return, since Inception BRL	24,55%

FCL Hedge	
Past 12 months	2,41%
Past 12 months as % of CDI	68,55%
Since Inception	165,74%

Although the massive currency depreciation that Brazil experienced this year distorts results a little bit, it is clear that this has been a very eventful and very positive year for our funds.

FCL Opportunities has enjoyed six consecutive months of positive performance and is now up almost 20% in Brazilian real this year. In USD our performance is still negative because of the devaluation of the Brazilian real and other currencies compared to the US Dollar.

It is important to note that unlike most other global funds based in Brazil, FCL Opportunities is not a “dollarized” fund: first, around 25% of its portfolio is comprised of Brazilian positions, mainly in the local stock market. Furthermore, we have an “emerging market bias” and a “BRICs bias” so in times when the US Dollar outperforms, our investors shouldn’t expect a 1 to 1 outperformance against the Brazilian currency because of that. For most of the time, US based positions are a minor part of our fund.

Happily, the opposite is also true: if the currently undervalued Brazilian real rises against the USD dollar in the next few quarters, and there are some signs that the US dollar is peaking against most currencies in this macroeconomic cycle, we shouldn’t necessarily underperform because of that. To sum it up, we are a niche stock picking global fund focusing on the best global long-term opportunities, not an “international diversification and dollarization fund” like most Brazilian global funds are.

Since the fund’s inception in January 30th, 2017 , FCL Opportunities performance is + 124,84% in Brazilian real (or a +24,55% annual compounded return) and + 23,41% in USD despite the US dollar’s massive increase against other currencies in the period.

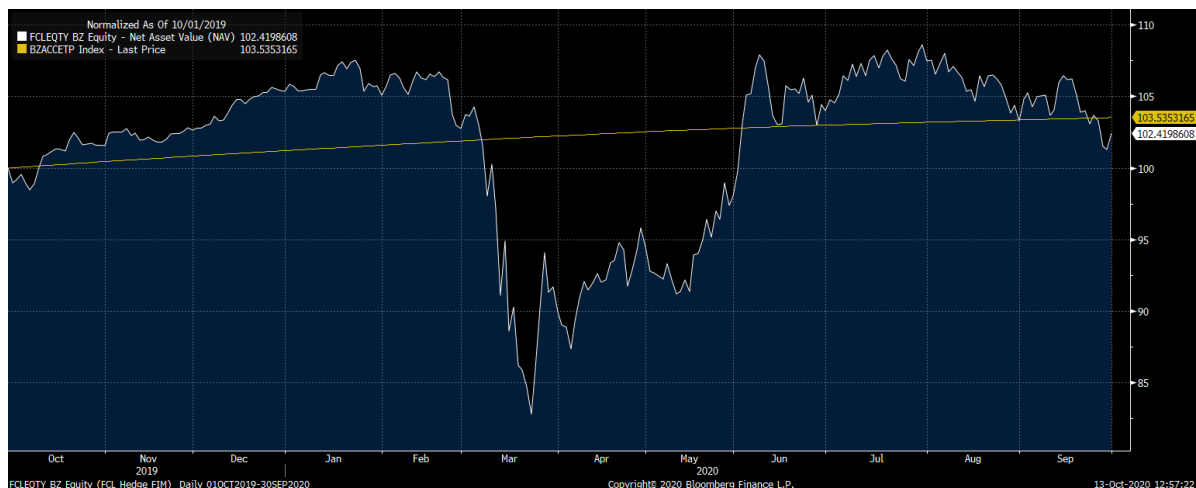


FCL Opportunities (blue), All Country Index ETF, Ibovespa (green), in local currencies.

Over this past year FCL Opportunities was mentioned in several papers and received diverse mentions as one of the top performing funds domiciled in Brazil not only in the global stock funds universe but also in the Brazilian fund management industry in general. In several of our partners and allocators platforms we are at the top or near the top performing funds.

Although we advise and remember our investors that a single year of results is mostly noise and can't be given too much importance, we are satisfied so far by our results over the past three and a half years that seem to show we were able to crack the code and spot a unique, profitable and overlooked niche in global stock markets.

As for FCL Hedge, the fund is almost on par with the Brazilian CDI over the past 12 months. We have a lot of love for Hedge, a fund that is still comprised of some of our earliest investors in the pre-FCL Opportunities days. It took this house a while but finally we believe we were able to unite FCL's global framework and mindset with the structure of a Brazilian multimarket fund and we have never been more excited about FCL Hedge's prospects. We trust results may follow soon and vow to work hard to bring FCL hedge onto the same path Opportunities was put these past few years. We are happy to announce Hedge will be listed in some investment platforms later this year, bringing a new generation of investors to this product that we believe, also offers something unique in the fund management industry. We are excited to see new investors joining ship and tasting the product.



FCL Hedge (blue) vs Brazilian CDI (green) , last 12 months

At the end of the third quarter of 2020, FCL Opportunities top 5 positions where

Position	Country	% Fund NAV
Joyy	China	12,66%
Anta	China	10,84%
Trip.com	China	8,47%
Vipshop	China	8,18%
Vale	Brazil	7,69%

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

Positions in ETFs and stocks	69,54%
Cash and Fixed Income	12,11%
Other positions	18,85%

For the next few quarters, our portfolio continues to show the following characteristic:

- We are overweight Asian consumption (including through European and American companies)
- We hold long term stakes in companies we think might be 21st century champions, including new, specific and innovative business models tailored to Asia, like Joyy and Vipshop that we think were still not completely understood by most western investors.
- We think the Brazilian currency and stock market are currently a big question mark. If the country puts its fiscal situation in order a massive repricing of assets could happen. Of course, this is not a certain outcome. Overall, we are constructive towards some specific names that have been assessing the market this year and continue to hold stakes in Vale, Yduqs and Fleury which we think are massively underpriced in virtually any scenario.
- As we said earlier, we owe a huge chunk of our profits so far for being able to spot two emerging champions before most market participants: Match Group and Anta. We are actively looking for other promising companies, in the luxury, tech and service sectors among others, hoping to add to this list.

To end on a more personal note, this manager turns 40 in November. As i approach with some self-reflection what is hopefully the middle point of my life, i realize i have many things to be thankful for.

I was blessed with a great upbringing in a loving family , have made and continue to make amazing friendships throughout my life, found love, had amazing experiences, memories and met unique individuals that i know fully well how privileged and lucky i am (in every sense of the word) to be able to meet and experience, found success in something that i love and decided to dedicate my life to which is trying to figure out global finance and the world it inhabits , have so much joy when not at work at the

company of my beautiful 8 year old son hat just in the past month teached me that South America actually has five different languages and that Russia is larger than Antarctica (I assure you dear investor that this global obsession it's either in the genes or I have been doing at least something right!) and on top of all that, of course, found and continue to build an amazing group of investors/friends/partners that entrusted us with their capital and partnership so this house could fulfill and expand on its mission to do something unique and with excellence.

To each of you, thank you very much for your partnership. I sincerely look forward to keep writing you investment letters and calling you partners for the next 40 years and more.

Sobre a FCL Capital

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