FCL *Capital*

3Q 2024

Dividends and rules of thumb: from Kahneman to quants to AI.

One of the most frequent questions our investors raise when dissecting this house's investment framework is: how much importance do we give to dividends in our investments? In other words, when selecting companies for our FCL Opportunities fund, to what extent do we give preference to dividend paying companies instead on non-dividend paying ones? And how should a stock investor approach the theme of dividends?

AT FCL Capital, our focus in on the long-term world changing ideas and companies. Many of these companies don't pay dividends yet. But at the same time, we consider ourselves value investors in the Benjamin Graham and Charlie Munger tradition. How to reconcile these two realities?

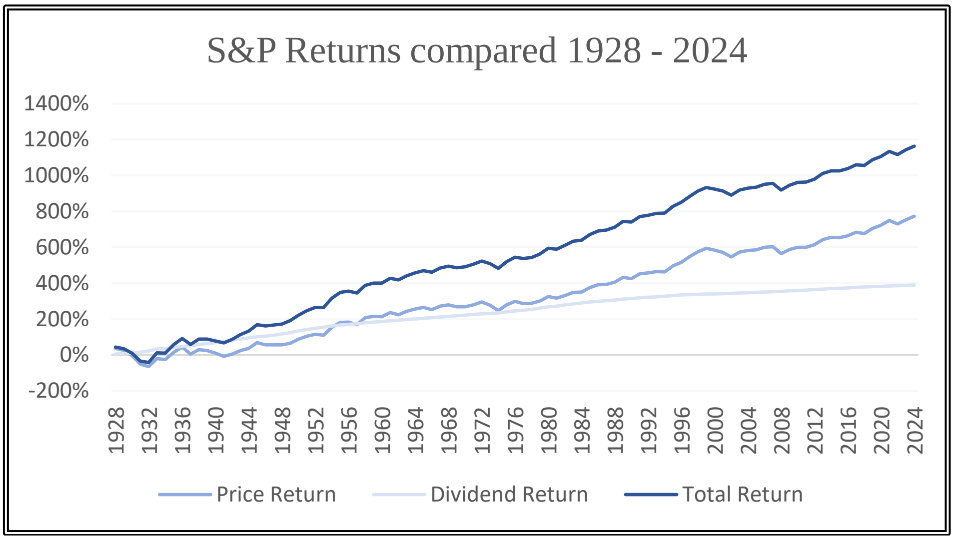
First of all, it is important to notice, there is no contradiction between growth and value. As Warren Buffett himself once noted, growth is "nothing more than one component of value" it goes into the calculation. It was Wall Street that created these two "buckets" to sell investment products, but an individual investor doesn't need to get into the hype and wear the label like if it was some kind of club.

Also, let's have in mind companies go through different cycles: the same "reliable" dividend providers of today probably were fast growing startups at some point. Of course, common sense would attest that a brand-new startup has a higher level of risk and a potentially much higher payoff if things go right than, say, Proctor and Gamble or Exxon. The latter are safer and will provide a relatively stable cash flow but obviously the people that really got immensely rich with them are and will always be the ones who invested first when they were unstable and uncertain startups. That's the nature of investing. As with anything in life, you will never have it all...

Probably most investors would want to have some exposure to both of these realities, some higher risk and higher reward bets while also having some reliable cash flow. Offense as well as defense, in different amounts for different investors, depending on their level of risk tolerance and time horizon.

That being said, there is no doubt that dividends pay a crucial role in any stock portfolio.

Let's look at the compounded returns of the S&P500 index with and without dividends reinvested in the past 100 years.



Like we often say, investing in stocks and holding them for the long term through ups and downs through the crisis and catastrophes, through the 50% drawdowns but also the recoveries which no one can really anticipate with precision, has been one of the greatest businesses in the past century, delivering compounded annual returns in excess of 10% annually in US dollar terms. And no wonder. Investing in stocks is having exposure to the best of humanity - the best ideas and most daring businessmen.

But since the various businesses in this marvelous hypothetical corporation called “the market” would produce a lot of cash, what should be done with it?

Classical financial theory states that when a business has good and profitable places to put this cash to use - like a new factory that will produce good returns and expand sales, like a startup that will use it to scale - then this cash should be reinvested.

At the same time, when reinvesting in the same business will only produce mediocre returns - think of a tobacco company that already has enough factories to support current and expected demand - then cash should be distributed - what is after all the point of investing in a business that doesn’t need new investments and won’t have productive uses of this cash?

This much is not controversial: 1) Cash should be distributed in the form of dividends or buybacks[1] when the business will only generate subpar reinvestment opportunities (bellow the cost of capital at financial theory jargon) and, to state the obvious: 2) A portfolio where an investor reinvests the cash the portfolio generates will have superior returns than a portfolio where distributed cash is not reinvested and taken out for consumption.

[1] In this letter we won´t dive too deep into the buybacks vs dividends discussion. Sufice to say that financial theory states that when a stock is undervalued buybacks (when a company purchases its own stock in the market) are preferred to dividends, especially when we consider the fact that since investor´s buy a stock, by definition they consider it to be a good investment. The major point here is that both stock buybacks and dividends are forms of capital returns to shareholders and dividends and buybacks might be understood almost indistinguishably for the purposes of this letter.

The confusion is most common at the stock level. Many investors believe that a stock paying dividends is inherently a superior investment or capable of producing better returns than one that doesn't pay dividends (yet).

There is no doubt that a dividend paying stock on average has lower risk and lower expected returns than, say, a small cap fast-growing tech stock that is not profitable yet. But that is not really what some people mean. They somehow think that dividends are an additional “free lunch” return that doesn’t take away from the regular return of that stock trading in the market. They are wrong about that.

Many investors also believe that just picking dividend paying stocks is a valid way to generate alpha. About that, things get interesting. We think the answer is nuanced: investors might be onto something when they seek and select dividend paying stocks, but not for the reasons they think.

First of all, financial theory is clear that the components of investment return don’t alter the return itself. Think of a business that is worth $1000, when considering its potential free cash flow, its cash, its plant and equipment and so forth. This same business has $200 in cash in the bank. Then the business pays $100 in dividends. Immediately the business will be worth $900 since it now has $100 less in cash than the day before. The same of course would be true with a non-listed company: if an owner pays itself a dividend the following day his business will have less money in the bank. “Duh”.

And as one would expect it, the stock market is pretty efficient in pricing the so called “ex-date” immediately after companies pay dividends when stock prices immediately adjust down for being “out” of dividends.

So no, the fact that a stock pays dividends does not mean itself that the stock is a good investment.

And you don’t need to believe in us: there are countless “dividend paying” stock portfolios and ETFs and mutual funds dedicated to this theme and their returns since the dawn of markets have been in aggregate not different than the returns of the market as a whole. In other words: dividend paying stocks as a while don’t outperform the benchmark.

As for the fact that the dividend “income” can be used while the stock sits unsold this argument is to this house the silliest of all: if you use the dividend income for purposes other than reinvesting it in the market that means you won’t enjoy the full market returns, only the returns of the stock prices themselves and not the total cash flows the company is able to generate.

And if, on the other hand, income is what you need or want, then it would be just the same to sell part of your portfolio even if it doesn’t pay dividends to produce “income” just like a dividend paying portfolio, but an alternative artificial way.

Remember, both dividends and stock sales are taxed at the same level in most countries. So, what matters at the end of the day is the full returns of your portfolio, comprised by stock price appreciation plus dividend distributions. Who cares if I own a $100 stock, the price stays the same, I receive $10 in dividends in the period and spend this money or if I own a $100 stock, it pays no dividends, the price rises to $110 and at the end of the period I sell $10 of this position because I need the money? The results are clearly identical.

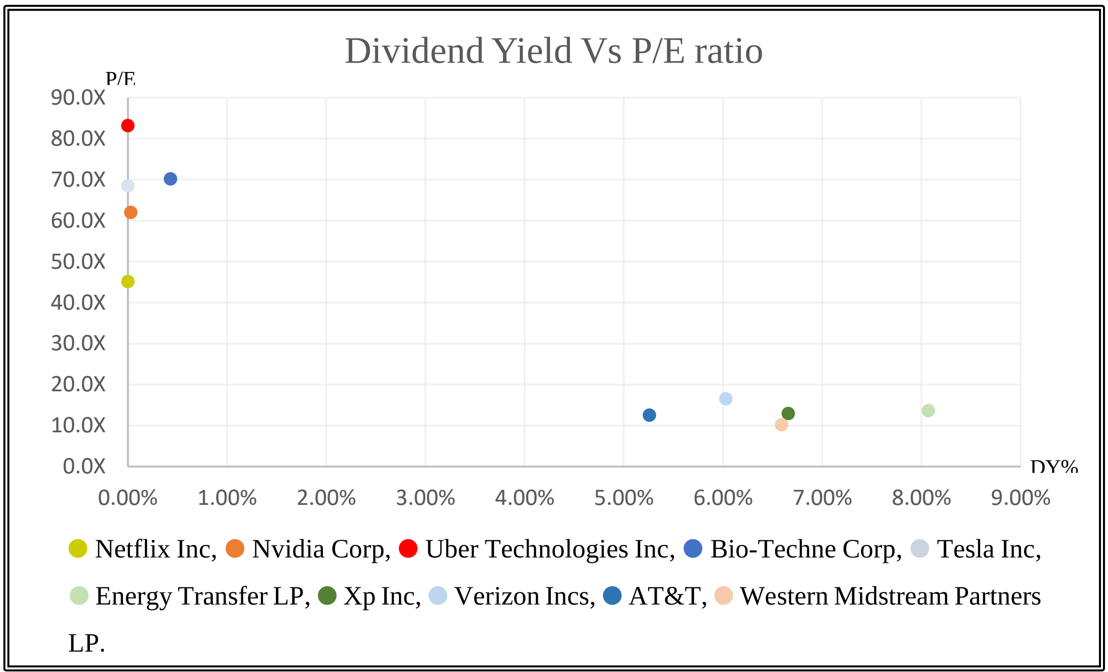
We could stop our letter here and it would be business as usual, but we won't. Because many investors feel they have a shot at beating the market when selecting dividend paying companies. Why is that so?

Because yes, we are convinced that for many investors, although they don't really know why, just focusing on dividend paying stocks can help them beat the market. Or at least can give them a somewhat decent strategy. And this will be the real focus of this letter.

Why selecting dividend paying stocks might help you to beat the market? Financial theory states that this shouldn't be the case. But why so many have success with this simple strategy?

The first factor that comes to mind is simply cheapness. The good old value investment in the Ben Graham style.

When blindly selecting the highest dividend yields, investors might be inadvertently selecting the cheapest stocks in the market. There is after all a giant correlation between being a cheap stock (having a low PE ratio, a low price to book ratio, a high Free cash flow yield, etc.) and having one of the highest dividend yields in the market. The highest dividend yields are comprised by cheap stocks. There is a giant intersection between the two camps.



And although as we said before selecting dividend paying stocks is no guarantee for investment success. Numerous empirical studies have shown that over longer periods of time even relatively simple value strategies, like selecting the stocks with lowest PE ratios outperform a random basket of stocks[2].

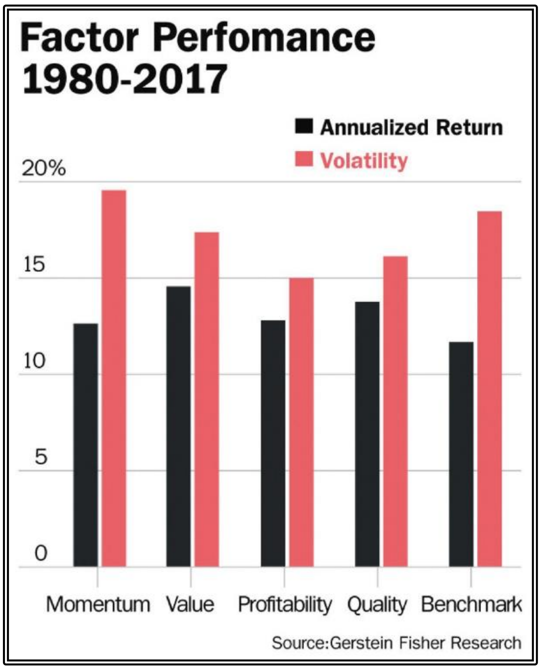
Adjacent to the "cheapness" factor there is a second reason a dividend paying portfolio might outperform: quality.

As investors know, the holy grail of stock investment is discounted free cash flow. And the trick is to select the companies that have durable, competitive advantages where their cash flows will last into the future. In other words, the trick is to find quality. The good companies.

And what are the good companies? How can we find them? There are of course endless arguments, investment philosophies and this house produces its own thesis from time to time in this very space to dissect and outline its investments as so many others do.

[2] https://www.pwmnet.com/the-enduring-benefits-of-value-stocks-in-a-growth-focused-market#:~:text=Numerous%20studies%20have%20shown%20that,market%20downturns%20or%20economic%20uncertainty.

But one good simplification is: good companies produce free cash flow. And to be able to pay dividends consistently, a company needs to produce free cash flow. So, to put into other terms, when selecting dividend paying stocks, investors might be inadvertently picking some of the highest quality companies and outperforming the market in the process[3].



So, when investors select the highest dividend yields, they might be picking some of the cheapest and, also some of the highest quality companies without knowing and beating the market in the process. But there is one last possible reason investors who follow this simple rule of thumb might be beating the market and it is the one that this house finds the most fascinating of all: psychology and investment biases.

It is widely accepted that investors, both individual amateurs and professional money managers have an overconfidence problem: they think they can not only beat the market, but at any moment analyze, process and react to investment information better than the average. Others might get emotional and act without thinking properly, of course, but not them!

So, it might sound surprising but ample academic study on investment returns achieved by thousands upon thousands of investors has shown that for most investors, especially the least sophisticated ones, following simple, even simplistic rules might help them outperform not only the market but also the returns they would achieve without those rules. A process, albeit a simple one, helps them overcome their doubts, helps them act with their brains and not their stomach.

[3] The legendary ‘’Buffett alpha is according to at least one prominent quant firm due to the fact the he picked the quality factor and it beat the market handsomely: https://www.aqr.com/Insights/Research/Journal-Article/Buffetts-Alpha.

And investors are not alone in that, overconfidence is a human problem. As Daniel Kahneman has shown is his magistral book “Thinking fast and Slow”[4] having simple lists and guidelines prevents errors and improves performance while helping people avoiding fatal mistakes they might not accept they would make, from pilots messing up basic steps during airplane takeoffs to doctors forgetting medical tools and operating the wrong leg during surgery procedures to investors buying at the top and selling at the bottom in the stock market.

These many types of human mistakes might occur due to negligence (“I don’t need to double check that, I already know it”), overconfidence (“Everyone is bad at this, but I am above the average!”) to getting emotional (“Everyone is selling, it will go to zero, better to sell it too!”). The harsh reality is that everyone thinks they can act rationally until the moment of panic arrives and people are usually too scared to put their neck on the line, and no wonder, human beings are not made to deviate from the herd in stressful situations.

Many investors have achieved surprising success with incredibly simple formulas like “only investing in stocks with a dividend yield above 5% per year” or “only investing in stocks with PE multiples bellow 20”, sometimes not even knowing the companies they were putting their money into.

While professionals might laugh at how simplistic these rules sound, and sure enough, no rule will free investors of mistakes and painful periods of underperformance or is guaranteed to beat the market, the simple fact of having the discipline of following a previous set guideline will make this investor automatically invest more when the market is cheaper (since more stocks will drop below the previously set multiple or above the desired yield in those moments) will help it overcome his emotions (since he can blame his method and won’t have to overthink) and will make it easier to find where value lies in the market (since his rules will guide him).

People may get emotional, euphoric, but rules are rules: usually dividend yields rise above the 5% threshold exactly when people are in panic, and stocks are cheap. So, to put it into other terms and in a way that maybe Kahneman would accept, simple frameworks and rules of thumb to guide us can liberate us a bit from our humanity.

Of course, over time the most radical school in the investment industry that puts rules above minds is probably the quants. At its most extreme end the humans that run the firms have no discretionarity at all when selecting and managing investments. At the other hand, classic stock pickers that think they can outcompete each other use no set methods and, in some cases, not even the help of any software or formulas. And there are obviously many strategies in between.

At this house we sit somewhat in the middle of the debate, armed (as so many others) with our stock screeners, our proprietary formulas and terminals but also leaving some room for human instinct and discretionarity.

[4] https://www.amazon.com/s?k=amazon+thinking+fast+and+slow&hvadid=511443271123&hvdev=c&hvlocphy=1026339&hvnetw=g&hvqmt=e&hvrand=4539035889024480867&hvtargid=kwd-861650096046&hydadcr=7464_9611828&tag=googhydr-20&ref=pd_sl_1tvpy88ot_e.

In this we are inspired by high level chess playing: while it is true that since 1997, when IBM's Deep Blue beat then world champion Garry Kasparov at chess, machines are better than humans (and current players like Magnus Carlsen train and get better by learning from machines) to this day the real world's best player is not the world's best chess playing computer, Deep Blue's successor. It is also not, of course, any human. It is a centaur. Some odd combination of the two. If we let a chess grandmaster use a chess supercomputer (and that didn't constitute cheating) that "player" would beat any other player in the world, both human and computer in standalone form.

That framework, this house believes, can be transported to investing, where in this age of Chat GPTs, the dawn of Artificial Intelligence and its wonderful promises in so many fields, humanity is left wondering where it will have an edge.

Our edge, we believe, will lie not only in caring for each other but also in using the tools and recombining them in new and promising ways. A centaur, where we use the rules but at least not yet completely let our "humanity" go.

The journey of learning and discovering in investing is not really at the end, we believe, but only starting. Sure, new tools will keep coming and the participants will need to adapt or perish. But the game, we suspect, will only get more interesting.

Portfolio recap: the setbacks

Usually in this space, this house dedicates a section of its quarterly letters to discuss a specific thesis in our portfolio: an investment inside our funds and our reasons and framework for investing in it.

While we will continue this modus operandi we also decided that it is worthwhile, from time to time, to give un update on our previous investments that once were featured in this space, how they are performing and if we still see reasons for holding our thesis.

So, we decided to use this quarterly letter to give our investors an update on three of the most crucial positions in our FCL Opportunities portfolio: Uber, PDD and Match. All of them were discussed in this space before.

Why those three? Because they are not only important investments but also the three are currently under intense scrutiny by the financial community. They are certainly not consensus investments (if investors should seek consensus investments is something we will leave to another time, but our guess is that our long-time readers already know the answer).

The fact is that in all three interesting financial news have led to a decline in share price that we think are temporary but that detracted from our performance. So, they could be seen as opportunities, as well as question marks. To put in other words, our success this year and next will certainly have a lot to do if these three positions go according to our plan or not. So, let's dig deeper into a recap into them:

Uber

Uber was until this past may the best performing position in our portfolio over the past year. Gradually, our thesis that Uber was at an inflection point, that its cash burning days were over and gradually it was becoming a utility in modern life (like the so-called mag 7 stocks) and that the sell side and financial analysts community was underestimating its cash generation potential for the future was proved right.

Indeed, Uber is on track to generate around $8 billion dollars in free cash flow next year, according to the now revised sell side consensus.

So, what went wrong?

Before we start to answer let's talk about another of our investments and one that also has wind in its sails: China's BYD.

To sum it up, our thesis in BYD is that the company will be able to take the crown from Tesla as the leader in electric vehicles because while the first electric vehicle buyers were affluent eco-enthusiasts from the west, in the future people will care more about price and convenience as opposed to novelty in ideology when buying their cars.

Tesla excels at being a cult and at having in Elon Musk a visionary entrepreneur. But to be number one, a company will have to have affordable models that can be used by the masses, especially in emerging markets (and Tesla's cheapest vehicle is at the same price level as BYD's premium ones) and tailored to different circumstances and tastes (while Tesla only has four different commercial models). That even before we start to discuss the Chinese companies, and in particular BYD unmatched engineering excellence and it's also visionary founder.

Uber in million USD	Current/LTM
Revenues	40,059.00
YoY growth	*14.44%*
Gross profit	12,968.00
Gross margin	*32.37%*
EBITDA	2,797.00
EBITDA margin	*6.98%*
Net income	2,011.00
Net income margin	*5.02%*
Price/Earnings	77.9X
Market cap.	156,708.90
Enterprise value	159,999.90
Free cash flow	4,753.00
Free cash flow yield	*11.86%*

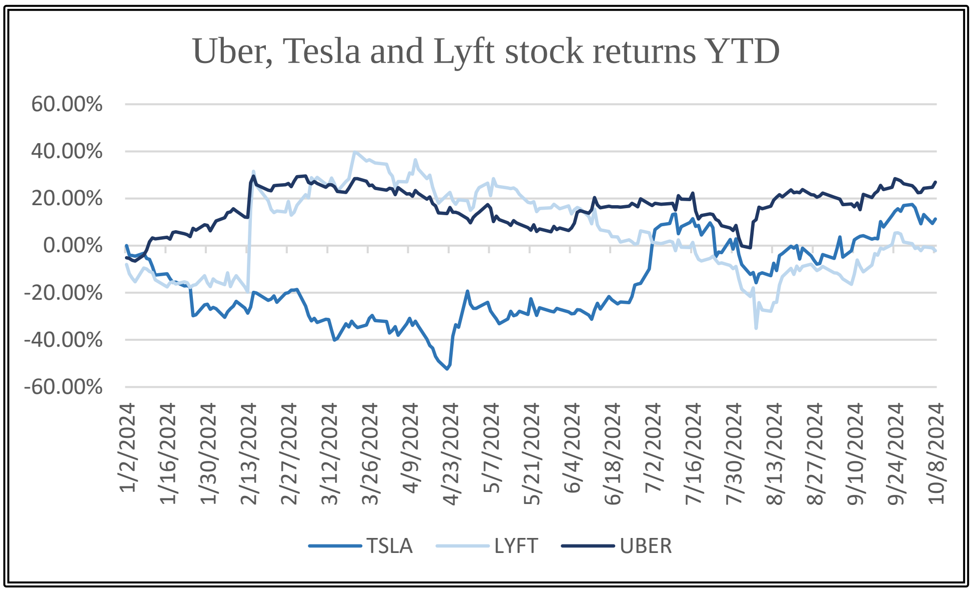
No wonder that Musk himself admitted recently that if left free to compete, the Chinese electric car industry will destroy its European and American competition[5].

But if there is one thing that Elon Musk really excels at, even more so than being an undeniably visionary entrepreneur, is being a salesman. Once he realized that he can't beat BYD, he pivoted. In May he tweeted that Tesla was not really a car company, after all (!), but an AI and automation company[6]. He proclaimed that tesla would solve autonomy and, presumably, it would destroy today's mobility companies, like Uber, Lyft and Didi in the process.

[5] https://www.cnbc.com/2024/01/25/elon-musk-says-chinese-ev-makers-will-demolish-other-companies.html#:~:text=Tech-,Elon%20Musk%20says%20Chinese%20EV%20makers%20will%20'pretty%20much%20demolish,most%20competitors%20without%20trade%20barriers&text=Elon%20Musk%20said%20Chinese%20electric,competition%20from%20these%20same%20companies.

[6] A sector that just by coincidence is in the middle of an intense hype wave.

The reaction was instantaneous, as you can imagine.



Inside the financial community, just when the debate was setting about Uber reaching financial profitability and the amazing leadership of Dara Khosrowshahi, investors then capitulated to a state of angsty that Uber's business model could be killed by a future with no human drivers.

At first glance, this idea makes sense: Uber's strength lies in its network effects. Riders choose it because it has the most drivers, and drivers prefer it because it has the most users. Breaking this advantage - similar to that of other online platforms like Meta and Match - is difficult unless something new, like robotaxis, emerges.

So, what were our thoughts?

One of the strongest ones, certainly, was our realization that, surprising as it seems, being based in Brazil is often helpful when investing for the long term in global companies. It seemed clear to us that Wall Street has a total lack of street smartness and that it has a belief that people all over the world live in similar conditions that American consumers.

Let's dive into the facts: as of now, Waymo, the US leader in automated driving, and which by the way uses Uber to reach more users, rides in only four US cities: San Francisco, Austin, Los Angeles and Atlanta. Even in these cities it only has rides for limited perimeters, and it is very, very far from displacing Uber of its leadership position there, even inside the limited area inside those cities where it is available.

Furthermore, Waymo itself has admitted that as of now its rides are subsidized and the company doesn't make a profit[7]. This can be done at limited scale, but obviously it won't be a solution to compete in the whole USA, let alone the world.

[7] Waymo is an Alphabet subsidiary, so it certainly has deep pockets backing it.

And that is Waymo. The only thing we have from Tesla is an announcement that on October 10th it will show the latest version of its auto driving product and the company doesn´t even claim it will be able to have no drivers[8] operating their cars while using it.

Waymo operates in limited circumstances for good reason: those four pilot US cities are relatively warm and don't have snow or other unstable weather conditions.

Even the streets of New York City would be impossible for autonomous vehicles to grasp with current technology: the snow makes conditions too unpredictable for current artificial intelligence and the technology hasn't cracked a way to operate there yet. And this is New York, the planet's most important city in the world's most technology advanced country. Good luck for AI to safely drive a passenger in India, in Brazil, in Indonesia and so many other places, where road signs and directions change daily and with no formal notice, where there are passersby, unpredictable driver and pedestrian behaviors and horrible road conditions from potholes to torrential rain to theft. Not even Google Maps or Waze are functional in some of these places good luck for autonomous vehicles there.

Our best guess is it will take another 20 years or so until autonomous vehicles take a sizable market share outside of the US, Europe or China. And that is even before considering that even then Uber's strengths might very well make it the obvious aggregator: in moments of peak demand people need a coordinator to know where the nearest vehicle is and a market maker that will set the prices. It is just more efficient than a fragmented market. Also, the business is full of complexities, per week two million items are lost on Ubers in the planet. There is maintenance, refueling, insurance. We just don't see uber being replaced, unlike what Wall Street thinks. Time will tell who is right and our investors should know that we still hold this important position.

PDD

This house has dedicated a special space to discuss PDD and its intriguing chairman and company in this publication and the previous, as you know. We won't dive too deeply, since most of our thinking can be read in the 1Q2023, 4Q2023, 1Q2024 and 2Q2024 letters.

But the interesting news piece about PDD occurred this past august 27th, when PDD released its second quarter of 2024 financial results. According to form, the results were outstanding, with net income and sales more than doubling year over year.

The puzzling part was the tone of the management in its financial report: "investors should be aware that the company's current growth trajectory and profitability should not be taken as a basis for the future"[9].

[8] We won´t even go in too much detail about Musk´s claim that Tesla buyers will also use its cars to make a buck when they are not using it because there are so many holes already exposed in this thinking that we don´t even take it seriously anymore.

[9] PDD 2Q2024 Financial Results.

This is puzzling because while it is common for companies and management to talk about specific difficulties, like warning about a drop of margins or sales growth in the next quarter or even next year, adopting a somber tone while not openly discussing the reasons sounds scary and puzzling.

But there was more: when noticing the company's amazing cash balance, well in excess of the company's realistic investment needs, an analyst argued about the possibility of dividends or share buybacks. Management flatly said in the analysts call, in which we also participated, that PDD had no intention of doing any of that for the next several years since it was still a growing company[10].

Again, while it is common for management to justify the fact it there won't be shareholders returns and shareholders gladly accepting that, it is very uncommon for a management team to state that "there won't be capital returns for the next several years" and even in companies where this is surely going to be the case there is little need to abruptly state that. Always better to leave the options open.

What it really seemed to us was that management was simply, believe it or not, desperately trying to take the company's share price down, a task in which it succeeded.

But why?

For seasoned China's observers, there are a few possible answers.

PDD has had incredible success in the past two years, becoming the new Chinese e-commerce champion. It is one of the fastest growing large companies in the world. Its app Temu has taken the US and Europe by storm.

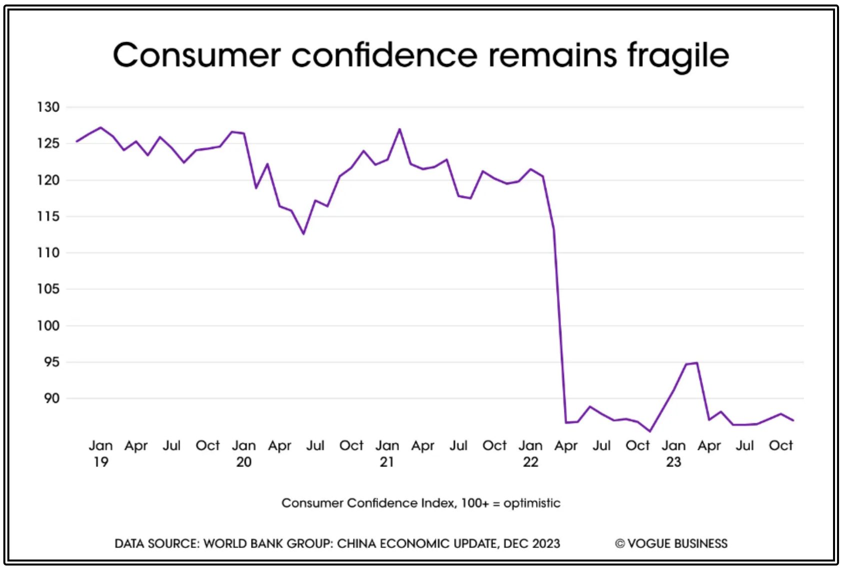
Today's China is a less optimistic and open place than it was a few years ago. The country's most famous businessman, Jack Ma went missing for a while in 2022 and then disappeared from public view after his company went through a painful "reparation process". One of the reasons was probably that Jack Ma was shining too much. Maybe even outshining the communist party.

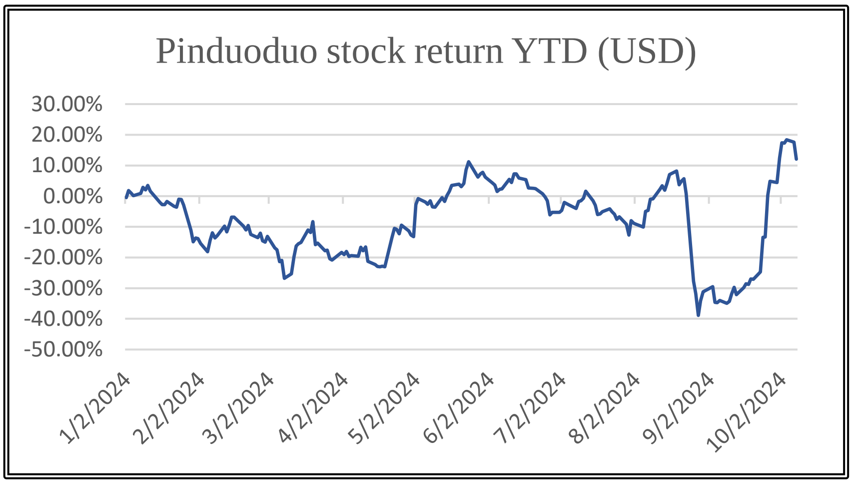
Colin Huang briefly became, following PDD's meteoric rise this year, China's richest man just like Jack Ma was in 2021 when the crackdown on Alibaba began and the communist party then launched its "common prosperity campaign" to, among other aims, combat "excessive income" whatever that means. It doesn't seem mad for Colin Huang to want to take PDD's share price down and "cede" the title of China's richest man in this context.

At its core, China's current problem is lack of confidence by its consumers and investors. Since the drastic Shanghai lockdowns in 2022 and the common prosperity campaign, the previous confidence in the Chinese system of governance and the competence of its government has been shattered. The country has clearly taken a more ideological turn. Some "excesses" of extravagance and conspicuous consumption have been persecuted.

[10] PDD Earnings Conference Call.

The famous Deng Xiaoping phrase, stating that "It doesn't matter the colour of the cat, what matters is if catches mice." was used to justify the country's economic opening back in the 1980s. The result was the most extraordinary process of human and economic development in the following four decades that the world has ever seen. Suddenly, however, Chinese consumers started worrying if their government is really competent, if their houses will continue to increase in value and if their children will have a better life than they did. Meanwhile, investors started worrying if the colour of the cat has started mattering.





Furthermore, PDD's success was also attracting scrutiny elsewhere: the west is currently revising its "de minimis" rules that allow packages of small value to enter the US or Europe and were used by the company to send its small value items. Some suppliers also complained about the company's grip, its onerous conditions and this, no doubt, could be material for the Chinese communist party to use in a possible campaign against PDD or its founder.

We still don't think anything fundamental changed: PDD is one of the planet's most ambitious and fantastic companies and it is led by a visionary founder. Competition will indeed rise in the industry, in part because competitors, including amazon are borrowing pages from PDD's book[11] and its huge net cash will quite possibly have interesting uses before the company decided to return part of it with its owners. We stay invested and look forward to the next few earning calls and meetings with management for clarifications about their statements made on august 27th.

China's government, meanwhile, has started realizing its own excesses and, in the pragmatic vein it takes most of the time, on the date we were producing this report (late September 2024), it has created a package with several stimulus measures[12], like lowering the cost of mortgages to help its real estate sector. One of the most interesting actions, in our opinion, was the creation of a state fund to promote share buybacks. Marxist dogma believes in investing and producing, not in returning capital to consumers and investors. But even the Chinese government started to feel bothered by the very depressed Chinese stock market prices and multiples. And the package was a green light from the government that shareholder returns in this environment in the form of buybacks and dividends are not only tolerated but encouraged.

Match

Finally Match is, as Tolstoy would put it, also a stock that has been suffering in its own way and for its own specific reasons despite the fact that its fundamentals remain intact: it is the clear leader (and thanks to Hinge's, which is Match's fastest growing dating app) with its market share even increasing in the US and Europe, in a fast growing and promising industry. It will generate more than a billion dollars in free cash flow this year.

Match in million USD	Current/LTM
Revenues	3,471.50
YoY growth	*8.07%*
Gross profit	2,508.50
Gross margin	*72.26%*
EBITDA	1,017.00
EBITDA margin	*29.30%*
Net income	649.90
Net income margin	*18.72%*
Price/Earnings	14.9X
Market cap.	9,678.80
Enterprise value	12,777.90
Free cash flow	920.10
Free cash flow yield	*26.50%*

[11] https://sherwood.news/business/amazon-temu-clone-discount-section-impacts/.
[12] https://www.bloomberg.com/news/articles/2024-09-24/china-frees-banks-to-lend-more-cuts-key-interest-rate.

The problem here afflicts many of the companies that saw its sales skyrocket during the pandemic: a certain hangover[13]. In other words, investors might be overcompensating due to their euphoria about these companies during the pandemic.

When it comes to Match, specifically, western press is inundated of articles and reports that claim that young people are suddenly giving up on dating apps and trying to find love in conventional ways.

There is not really much data to back this anecdotal opinion that went mainstream. Tinder's number of users, according to every independent measurement both by the company and by independent providers has plateaued but not decreased significantly. And even the small decrease it has endured might be explained by the fact that the prices for users to access its premium features have increased[16].

Match has also featured prominently in many of this house's past investment letters starting with our lead thesis back in May 2016[17].

Overall, its secret sauce for success remains a mystery to many. Tinder has never been the most efficient online way to find love: it allows for little customization and speed. Instead, although the company will never admit it, the real reason for its success is the gamification: users are really playing a game when they swipe right or left for so many potential mates' profiles in the way that has now became mainstream. It is not efficient; it helps to pass the time. In other words, its own inefficiency made Tinder the global sensation it still is.

We have been investors in Match since its IPO, back in 2015. After watching our investment grow more than sevenfold in what is to this day one of this house's most important and profitable investments, we exited our position back in 2021.

After just two years, thanks to the "hangover" we alluded before, our fund has once again invested in the company, an investment that is now, a little over a year later, once again one of the most important of our FCL Opportunities fund.

At present valuation, Match is worth around 10 billion dollars, and it is expected to generate $1 billion in free cash flow this year and around $600 million in net profits while still growing its sales and reaching an inflection point in number of users.

Just three years ago, around the time we exited our position, Match was worth around 40 billion dollars, but it was less profitable than it is now, which tells something about the "manic depressive" called Mr. market, in the eternal tale told by Benjamin Graham.

[13] Interestingly, this problem also affects another of our invested companies: Hellofresh, which also remains a promising industry. Unfortunately, due to space limits we couldn't discuss this investment in this letter.

[14] https://time.com/6836033/gen-z-ditching-dating-apps/.

[15] https://www.economist.com/business/2024/08/08/why-people-have-fallen-out-of-love-with-dating

[16] Match 2Q2024 Release report.

[17] FCL Capital May 2016 Letter.

There are of course valid concerns about Match. During the pandemic, the so coveted young female demographic, which has eluded dating apps since the early days of the industry finally entered a masse as new users. Will they remain? Also, many observers think the industry poised for a revamp. Is its current model sustainable?

The focal point for this house is that Match has reinvented its own industry several times, from the desktop era to the mobile age with Tinder and now it has a chance with AI to reset expectations once again. Not many companies were able to remain in pole position through so many technological changes, but we believe Match, with its IP properties, its management team and track record is best poised of all to continue to lead the space.

Performance

FCL Opportunities Returns	
Year To Date (BRL)	9.98%
Year To Date (USD)	-2.08%
12 Months (BRL)	10.29%
12 Months (USD)	4.19%
Since Inception (BRL)	118.14%
Since Inception (USD)	23.84%
Annualized Rate of return (BRL)	10.12%
Annualized Rate of return (USD)	2.38%

FCL Opportunities Geographic Distribution	% AUM
China	37.91%
EUA	24.53%
Europa	15.38%
India	9.06%
Brazil	5.84%
World	5.33%
Turkey	0.16%

FCL Opportunities Top 5 Concentration	% AUM
Anta Sports	14.06%
Pinduoduo	13.51%
Uber	13.40%
BYD	10.16%
Match	9.27%

FCL Opportunities Sector Distribution	% AUM
Consumer Discretionary	36.94%
Technology	13.40%
Communication Services	11.13%
Financials	11.05%
Industrials	10.16%
ETFS:	5.50%
Staple	4.56%
Healthcare	3.85%
Commercial Services	0.93%
Consumer Durables	0.70%

FCL Opportunities Exchange Exposure	% AUM
RMB	36.94%
USD	25.34%
EUR	15.38%
INR	9.06%
BRL	6.82%
Others	5.49%

FCL Opportunities Portfolio Concentration	% AUM
Top 5	60.41%
Top 10	91.01%
Top 15	98.21%

FCL Opportunities shares increased 9,98% in the year of 2024 so far. Over the past 12 months to September 30th, 2024, the fund's performance was +12,26%. In US Dollar terms the same results were -1,94% and + 3,33% respectively.

Certainly, the most consequential and important week of the quarter was the last one.

In this performance section we will outline the series of events that transpired in that week and in our next quarterly letter we will dedicate our initial section to the theme of Non normally distributed, or as this house prefers to call them, irregular returns. It was certainly and eventful week about which we thought we should draw a more in-depth analysis:

September 24th:

As disappointment about the Chinese economic performance was becoming entrenched ere it starting to become a consensus that the country would not achieve this year's 5% annual economic growth target. Over the past few years, for various reasons that went from limits of risk tolerance to ideological, several important investors declared that China as a country and the Chinese markets were "uninvestible".

China´s central Bank governor, Pang Gongsheng invited journalists for a conference about new economic policies. This was unusual because seasoned China´s observers know that September is not usually a month of new economic measures, usually reserved for the first half of the year, usually during the month of march.

The scale and depth of the measure shocked the market out of its disillusionment: the Central Bank announced that reserve requirements would be slashed by 0.5%, injecting 1 trillion yuan into the financial system. In addition, it revealed lower interest rates on existing mortgages, benefiting 50 million families. As is well known, the real estate sector - particularly housing prices - is crucial to Chinese consumers' wealth and economic well-being, as it represents the majority of the country's wealth.

At that point, Gongsheng's words were just promises, but they were enough to stir up the markets and send Chinese indexes flying. Our firm got the scoop instantly, tuning in live to the press conference. We took it as a positive sign, but didn't get carried away.

September 25th:

Just one day after announcing what is now called "the stimulus blitz" the market was moving sideways, waiting for the Central Bank's moves to be confirmed. Rumors started flying in the major media outlets, giving more weight to Gongsheng's promises, and the markets popped off again. But still, no certainties yet.

September 26th:

New real estate relaxation measures, this time in Shanghai and other cities, where many second house owners and other investors are now no longer forbidden of owning multiple homes. This measure alone sent global miners share prices soaring since China consumes most of the world transnational iron ore.

Then what we think was the most unexpected measure of all: the announcement of an "stability mechanism" which is really in essence a kind of investment fund, that would give credit to companies repurchase their own stock at today's depressed valuations.

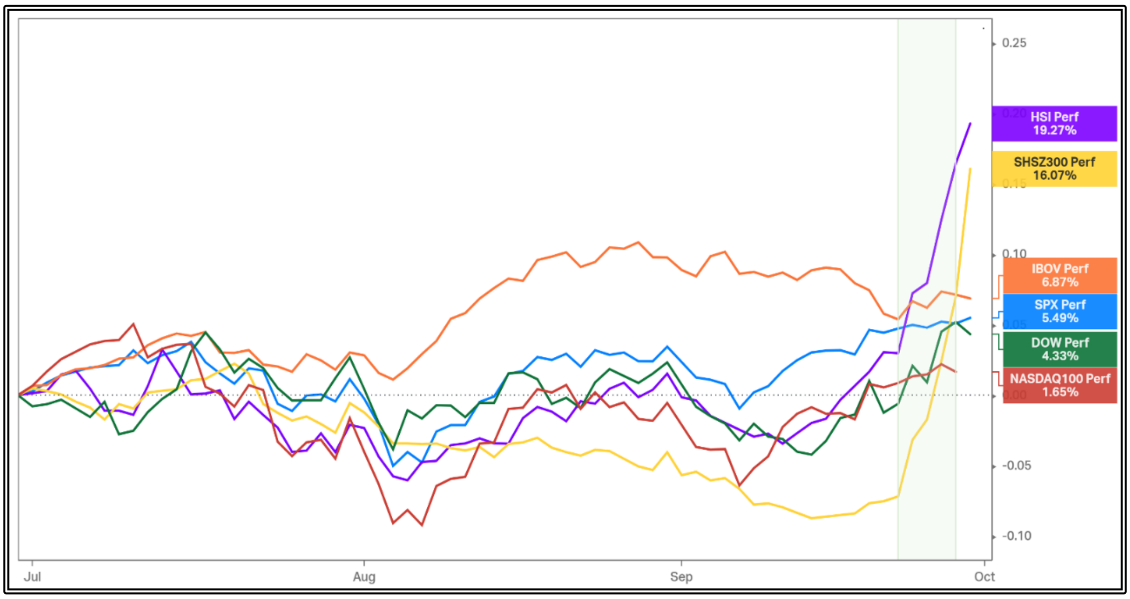
It is worth remembering since the beginning of China's economic slowdown post covid, many economists have pointed[18] out that low consumption, which is in part the result of low consumer expectations is the main culprit in the economy. But favoring consumption instead of production goes against Marxist ideology that has always favored producing things and not economic wealth per se.

Shareholders returns are even a more extreme form of Anglo-Saxan capitalism that favors consumers instead of producers that most Chinese watchers wouldn't dare to dream.

Well, the state buyback fund is so interesting because it shows that even for the Chinese Communist Party, the incredibly low Chinese share prices and valuations were hurting sentiment and morale and became a problem. Enough was enough and shares should rise!

September 27th: The big day.

The Central Bank came through, cutting the reserve requirement by 0.5%, aiming to inject 1 trillion yuan to stabilize the banking system. As promised, the benchmark interest rate dropped by 0.2% to 1.5% to ease mortgage costs. On top of that, the Chinese Communist government announced 1 trillion yuan would be raised through special bonds, used to boost subsidies for a consumer goods replacement program, and to provide a monthly allowance of around 800 yuan per kid for all families with two or more children, excluding the firstborn.

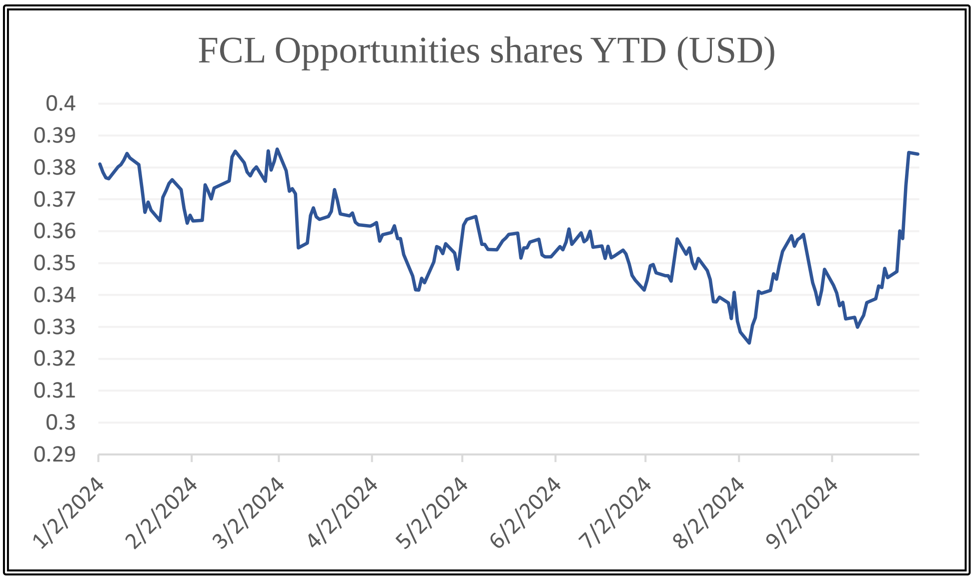


[18] https://carnegieendowment.org/posts/2024/07/why-is-it-so-hard-for-china-to-boost-domestic-demand?lang=en.

Half a world away, the Chinese stimulus blitz was being felt not only through Chinese share prices but also in countless other global companies and sectors, from miners to luxury companies and more, since so much global economic activity is intimately linked to the Chinese economy.

Our investment company, Moncler, multiple times a theme of our past letters and which was already having a good week announced a deal with the giant French luxury conglomerate LVHM[19], where the latter would become a minority shareholder (and also presumably first in line to be an eventual acquirer if CEO Remo Ruffini ever decides to sell his company).

All in all, it was an eventful week that put our FCL Opportunities fund among the top performing equity funds in the Brazilian industry this year. As always, we remind our investors that our internal metric of success is instead long-term performance, preferably measured in compounded annual US dollar returns over the very long term.



As always, we couldn't finish this letter without thanking our investors for their long-term trust in us and for their shared enthusiasm and vision. Today and always, thank you very much,

FCL Team.

[19] https://www.lvmh.com/publications/remo-ruffini-partners-with-lvmh.