

FCL *Capital*

3Q 2022

New existentialism and the end of history

“You make most of your money in a bear market, you just don’t realize it at the time.”

- Shelby Cullom Davis

Among the countless publications this house regularly follows is the Bank of America Fund Managers Survey, usually an informative, if unremarkable, survey of global investment managers and how they are allocating their clients’ capital.

One recent survey caught our attention and was more discussed than usual by ourselves and other market participants.

When asked if they were confident in respect to taking more or less risk than normal for their respective mandates, fund managers around the world answered that they were the most conservative and prudent, and consequently having less risk exposure, than at any other time since the survey began collecting data over a quarter of a century ago.



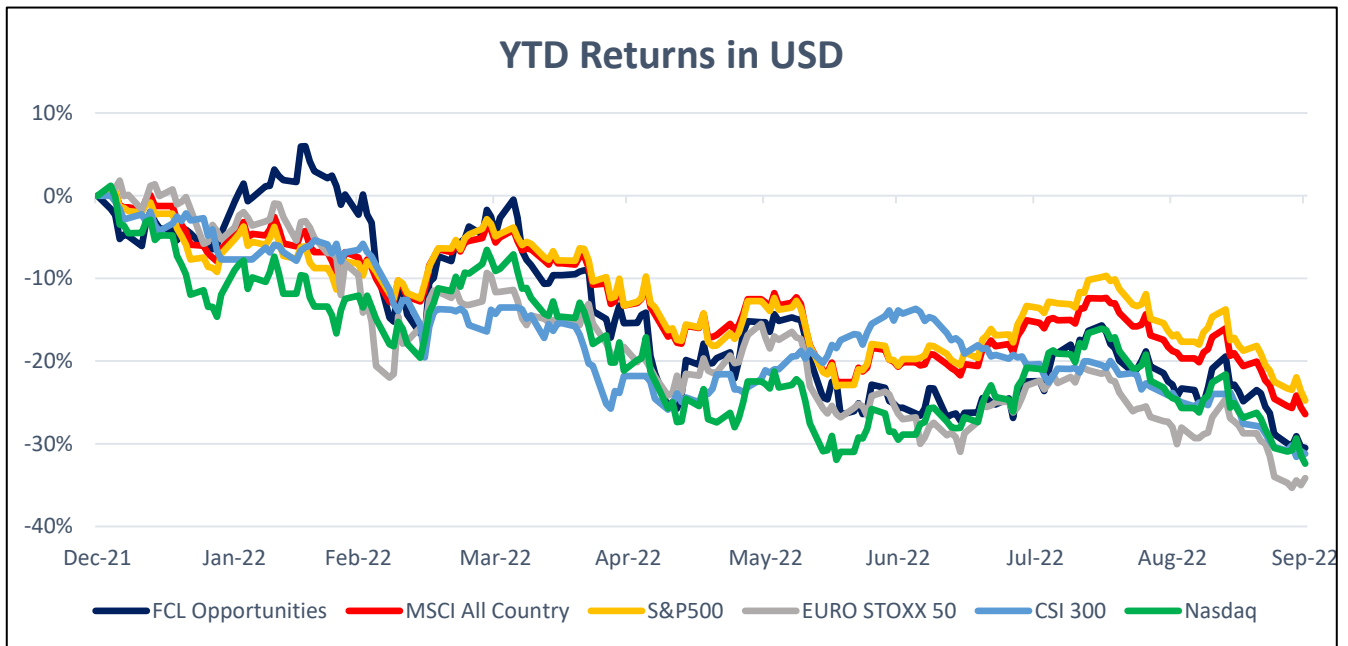
Just to name a few moments we went through in the past 25 years to give a better idea of what this implies:

- Fund managers are more bearish and with lower risk exposure than during the height of the global financial crisis in October 2008, when no one knew if the global financial system would, basically, continue to exist;

- Fund managers are now, and this survey was taken just a couple of months ago, significantly more bearish than when Covid first spread around the world and no one knew how long or how deadly it would be;
- Fund managers are now way more bearish than during the dot.com burst, than at any moment of the Iraq War, or in the aftermath of 9/11 when no one knew how big a threat global terrorism would be.

To sum it up, global financial managers are, in the year 2022, the most pessimistic they have ever been in a world that over the past few decades experienced numerous crises, wars, financial meltdowns and a pandemic (each of those times emerging stronger and, in due time, with new stock markets heights).

With major stock and bond indexes all down between 20% and 40% in the year to date, we see widespread panic.



Source: Bloomberg, FCL Capital

This letter is an attempt to answer the question: why is that so?

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Since the dawn of time, investors have oscillated between periods of euphoria and stress. This is the famous “greed and fear” duo as in the words of Warren Buffett or “the pendulum” as Howard Marks puts it.

Considering we are now at a time of despair, this house's attempt to answer the question above has led us to four different answers, one real and three psychological in nature.

Starting by the "real reason": the world is undoubtedly facing a much worse scenario than a few years ago and there is no denying this fact.

Sadly, with the advent of Russia's invasion of Ukraine, the year 2022 witnessed the first major conflict in European soil since World War Two and the geopolitical situation is only expected to get worse with the growing rivalry between China and the US, which could lead to dangerous escalations in the future.

Equally important, over the past year we learned that policy makers and economic agents were caught ill prepared for the robust resumption of economic activity following the end of Covid-related lockdowns. This is especially true for central banks in developed economies that were still practicing record low interest rates when the economic recovery was already in full swing and pushing prices up due to supply side issues.

Finally, the rapid increase in interest rates needed to combat the worse inflation problem faced by developed markets in a generation caused global asset prices valuations to nosedive as asset prices are, after all, worth the sum of discounted cash flows and since those cash flows are now discounted at much higher rates, their present value falls.

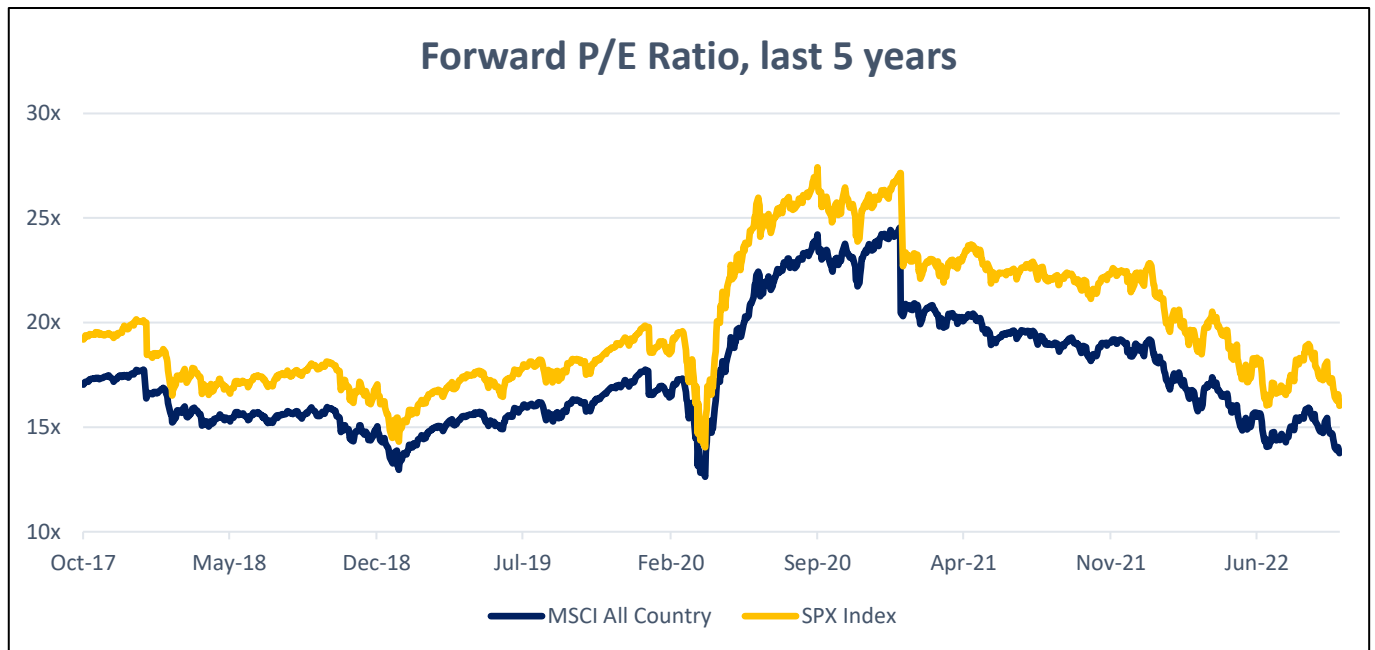
Considering how severe the inflation problem is across the planet, it is very likely that central banks will need to engineer a recession to bring supply and demand of labor back to equilibrium¹. Historically, there're not many instances of inflation this high falling back to tolerable levels without considerable economic pain.

To put it in simpler terms, it is a bad global macroeconomic situation out there.

This background leads to the ugly conclusion that of the four main drivers of financial asset prices (Inflation, Growth, Interest Rates and Risk Premiums) all of them are pointing at the wrong direction: inflation is up, growth is (and will increasingly be) pointing down, interest rates are way up and so are risk premiums that investors demand for investing in risky assets.

The result is the drastic fall in global equity valuations we experienced in the past year.

¹ Leading to an increased focus on the unemployment rate and the Beveridge curve, for economic nerds.



Source: Bloomberg, FCL Capital

So is it time to sell stocks and run for the hills?

No.

We think the market is overdoing it and we give you three reasons why. The three psychological, as opposed to real, reasons for this year's stock market rout.

Psychological Reason #1: It is human nature to overestimate the here and now.

We as humans always tend to think that whatever condition and cycle we are in at the moment is permanent. That things might have changed in the past but now, finally, we reached the "end of history", not only in geopolitical terms but in personal ones too.

For example, in a very famous study, when asked "how much your life and preferences have changed in the past 10 years?" and "how much do you think your life will change in the next 10?" participants consistently claimed their lives have of course changed quite a lot in the past 10 years, but at the same time they don't really think the next 10 years will bring as much change to them. They think that now, finally, they are settled in whatever condition they are in.

In a fantastic Ted Talk², psychologist Dan Gilbert shows our tendency to think we reached a personal "end of history" and that whatever changes we went through, now we see

² <https://youtu.be/XNbR54Gpj4>

ourselves as having finally reached a definitive state in terms of personality, preferences, etc. that won't change anymore³.

In finance, that state of mind inevitably leads to a belief that whatever cycle we are in will never end: bull markets will last forever because things changed for good or bear markets will go all their way to zero because nothing will ever be the same again.

In fact, the most confident market participants are in the immutability of the cycles, the stronger the case that these very cycles are reaching extremes. Financial literature is littered with examples of terrible timing, when a cycle was believed to be permanent: from the “we finally reached a permanent high plateau for equities” uttered by Irvin Fischer in the 1929 bull market just before the Great Depression; to the “Death of Equities” Fortune cover in 1979, followed by the greatest bull market in history; to the “Brazil Takes Off” The Economist cover right before a lost decade for the country.



The fact that the mindset changes so fast both in society as at the personal level has several implications.

In society at large it reminds this house, composed by self-professed libertarians, that we should be very careful when restricting free speech. We live in a time when people think it is normal for a mob to burn statues of individuals that lived 200 years ago and demand they had the sensitivities of the 21st century, but don't ever imagine that a mob somewhere in 200 years might want to burn statues of people alive today because we also can't foresee what kind of values and sensitivities people will have in the distant future. In fact, it is not infrequently that the craziest, most radical, most discredited voices in a certain

³ In psychology such beliefs could be related to the Winnicottian notion of a “fear of breakdown”, we as humans fear discontinuity, death, uncertainty and want to avoid or at least delude ourselves we can avoid it.

point in time turn out to be the rational visionaries that take the planet forward. We need the misfits, the contrarians and always will.

In finance, this bias means that we as economic agents have a very difficult time seeing through the cycles where good times lead to bad times and vice versa. One does not need to go far.

Just over a year ago, a series of all-time highs for technology companies, against which we wrote about in this space and towards which we professed our skepticism⁴, was in vogue. It was the “new economy”, the “new normal” and people needed to understand that a new era of exponential growth was upon us.



Source: Bloomberg, FCL Capital

Nowadays of course every negative piece of news proves that “the good times are over forever”⁵.

The pendulum, as ever, keeps swinging. Don’t be fooled to think it will, for the first time, stop and not move again.

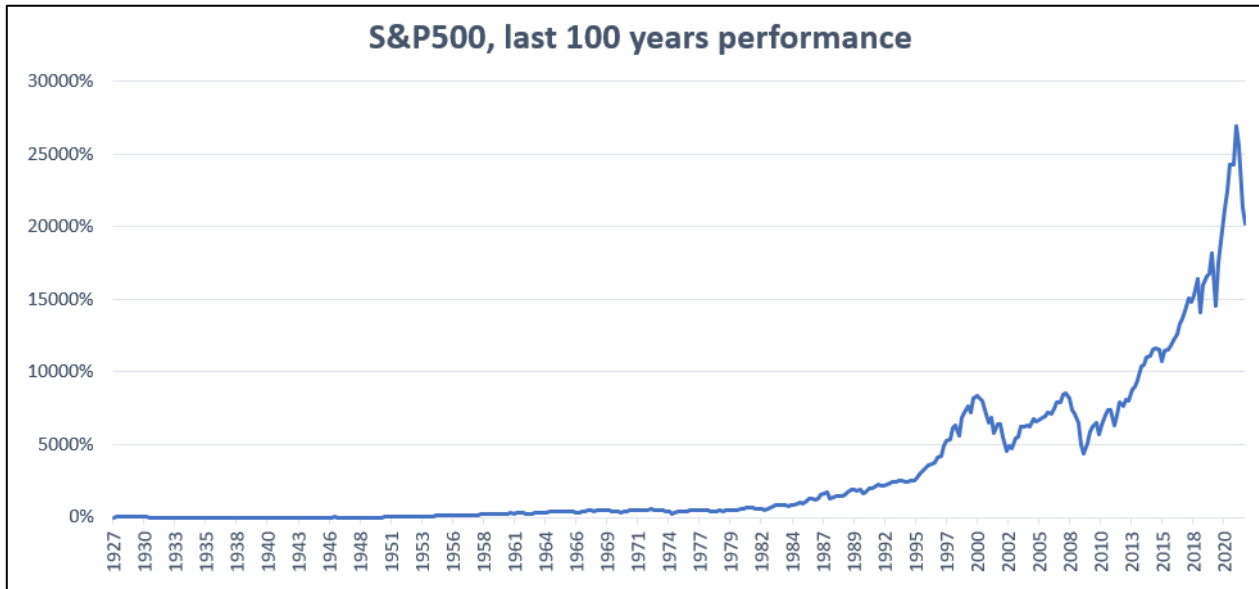
Psychological Reason #2: We are going through a new existentialism.

Pessimism brings status. Pessimism makes people look smarter. Global stock markets are a fantastic machine of wealth creation, with stocks going up roughly 10% annually in US

⁴ FCL Letter 4Q 2020 - https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/8d6b17_a78e179454ee4ed680f6cb847c9bccff.pdf

⁵ <https://www.ft.com/content/b34aff16-5ccb-4412-9b03-b987bdaac3b0> ; <https://www.bloomberg.com/news/newsletters/2022-09-27/global-market-stress-is-piling-up-something-is-about-to-break> ; <https://www.bloomberg.com/news/articles/2022-09-27/stock-bear-market-will-get-whole-lot-worse-when-credit-wakes-up>

dollar terms for the past century. But a pessimist case always gets more attention than an optimist one, since humans are averse to losses and give more importance for any loss they might endure than to potential gains.



Source: Bloomberg, FCL Capital

Over the past few years, as stock markets were testing new heights, we went through what was probably history's most hated bull market. Day after day pundits speculated in financial media, for years, what would finally cause the end that bull market. Of course eventually they were proven correct, since as we just saw, every cycle turns and that bull market had to end someday.

Now, each day of rising stocks brings a spike in google terms for "bear market rally" i.e. a rise in stock markets inside a larger downtrend.

There are some curious examples: Zoom is trading at an almost similar market cap as in 2019, before the pandemic when its revenues were 10 times smaller. HelloFresh is now a five times larger company than in 2019 and its share price are back to near the same levels. Funnily enough, many sell side analysts that rated their stocks a "buy" when their multiples were several times higher, now rate "hold" or even "sell".

Zoom		
(in millions)	2019	2022 (TTM)
Revenue	331	4.295
Market Cap	21.267	23.044

Hellofresh		
(in millions)	2019	2022 (TTM)
Revenue	1.809	6.868
Market Cap	3.071	3.715

Peloton		
(in millions)	2019	2022 (TTM)
Revenue	915	3.582
Market Cap	17.406	2.855

Some pandemic winners and growth companies compose a strange group where even if 100% of their pandemic-induced revenue increases evaporated (and that won't be the case

because those companies are now significantly stronger by the advent of work from home that is definitely not going away) even then, they now trade cheaper than when no one knew a pandemic would happen and benefit them. In other words, pandemic winners are now worth less than before the pandemic even existed. The market seems to think that somehow MORE than 100% of the benefits those companies accrued during the pandemic will be gone.

Existentialism of course was a philosophical movement much in vogue in post-war France, led by figures like Jean Paul Sartre. It maintained that the individual had an “existential angst” a dread, which was an understandable feeling for a Europe that had just witnessed the horrors of the Holocaust and World War Two.

This house thinks it is fair to say that the world now, for very different reasons, is experiencing something that could be called a new existentialism, a new era of malaise and pessimism, in different fields and certainly including global finance.

It is surprisingly often that lone wolves and those away from the mainstream, the contrarians, turn out to prove everyone wrong⁶.

So this house asks: who, in the current global financial markets, where practically every opinion can be seen and heard, is a convict bull? Who is the guy that advises everyone to load in stocks as so many were advising before the dot.com bubble and during other moments in history?

We as humans don't like to deviate from the herd and the herd is as bearish as it has ever been. When no one is bullish it might be a good idea to take a look at the bullish case, since the other side of the trade is pretty much well covered

Psychological Reason #3: Market timing and short-term thinking

Finally, we get to the third and perhaps most important reason we think this bear market could end soon: the whole architecture of the financial industry is designed to make people think that market timing is everything, or at least, the most important thing when it comes to investing.

Blame it on brokers' commissions, the eternal fee chasing nature of the industry, the way bonuses are designed, financial media and their specialists' opinions and also the way investors think about their portfolios, or maybe all of the above, but the fact is that every day people attempt to predict how the market is and how it will behave in the future. Financial markets are obsessed about the short term and this is a fact. Despite being mostly a bad habit for investors, who get obsessed about the short term while neglecting returns of a longer and more consistent kind, it is actually good, in some ways, as it allows astute long-term investors to use it to their advantage.

Just in this current bear market, some notable sentences were uttered, like: “The market may be cheap but we don't think it has fallen everything yet so it's not time to jump back

⁶ As seen in the global financial crisis when a few misfit hedge fund managers shorted the subprime bubble.

on ship”; “We are waiting for a complete meltdown, only then we will think of buying again”; and, among all the recent remarks, our favorite: “In previous recessions stock multiples fell to valuations two standard deviations below long term averages so we are waiting on the sidelines until that happens again”.

The point in common in all of this behavior is the belief in market timing, that one can predict the market, that the market owes you something and it is supposed to behave in a certain way that you can time.

Unfortunately this belief is widespread. Note, the S&P500 has delivered 10% annual returns for the past century. It is too good to be true. But what any prospective investor will ever ask when it comes to stocks is “is now a good time to invest in stocks?”

Let’s think about the question for a while. “Is now a good time?”. What everyone is deep down really asking is: “will stocks go up right after the moment I finally buy so I can feel safe and happy about my actions?”

The good news is that the stock markets rewards patient investors. As it is sometimes noted, there are no “fixed income billionaires”, the only possible way for the vast majority of investors to enjoy returns consistently above inflation over the long term is to be exposed to equities, to real assets⁷. In other words, and to answer the question: yes, it is always a good time. And we have no clue that if next day, or next quarter, or even next year, the stock market will go up or down.

Since simple exposure to a broad equity index like the S&P500 practically guarantees returns way above fixed income and inflation over the very long term, it is obvious to us that most investors should have most of their liquid investments in equities (with a few exceptions such as people near or in retirement).

But now let us ask the question: can an investor improve on those returns by going in the market just before its best moments and getting out before bear markets? Can someone time it?

Unfortunately the evidence points to the contrary. Maybe a few select individuals around the globe can do just that⁸ but the vast majority tends to get euphoric and more aggressive when the market reaches new heights and scared and depressed when it is at lows. In other words, they make their returns much worse than if they were simply holding the assets through the whole time. As we just saw above, investors tend to extrapolate the present into the future so it is incredibly difficult to predict when the cycles will turn.

The obvious conclusion is that for the vast majority of investors including institutional ones, our recipe for long term success is quite simple:

- 1) Be invested in a globally diversified equity portfolio and have this as the core of your liquid assets, with some fixed income investments in consideration for short- and medium-term expense commitments.

⁷ We mean equity and real assets in a broad sense, also encompassing categories like venture capital and private equity besides global equity markets.

⁸ A few talented global macro investors and also so-called quant hedge funds come to our minds.

- 2) Be invested all the time, through good times and bad, not trying to time the market.

One startling fact about equity investing: if you decide to day trade, your odds of success are pretty much fifty/fifty. It's a roll of the dice. But as your time horizon progresses, your odds magically increase. There are no 20-year periods of stock markets going down in the US for example⁹.

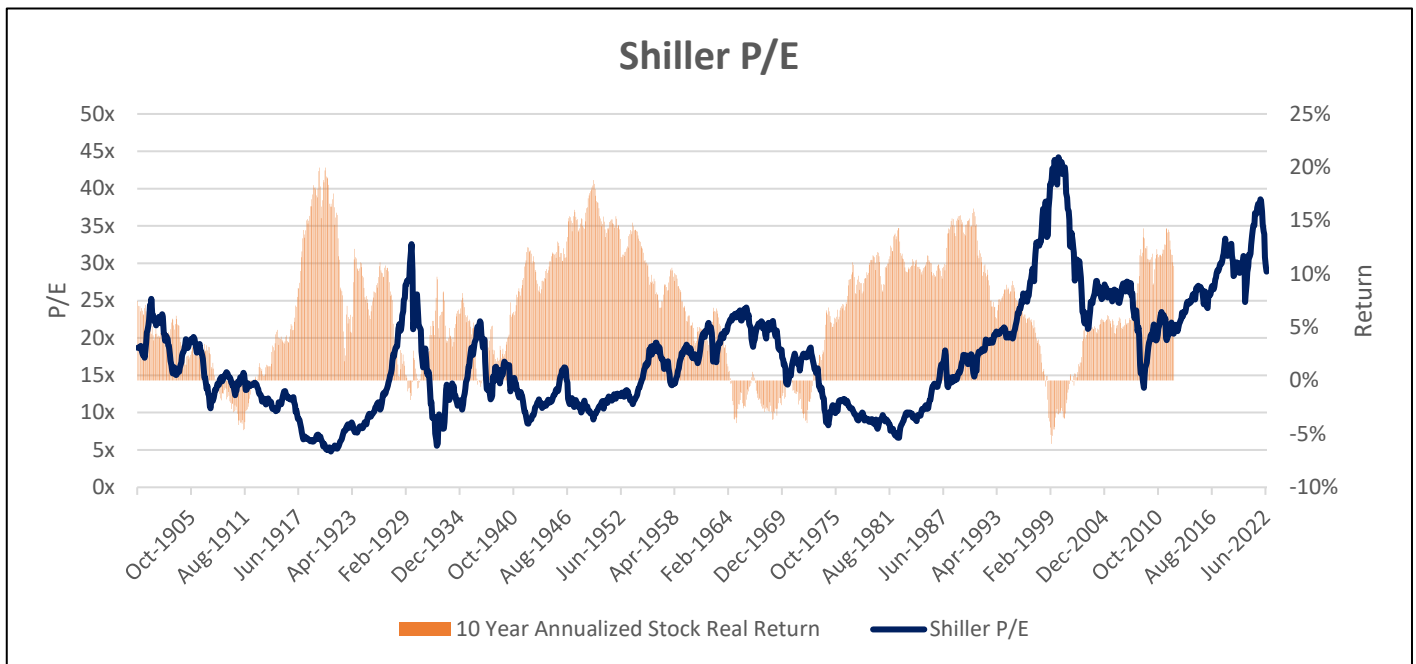
Why not? Because the global economy increases over time and with time the profits of corporations and the possibilities of entrepreneurship.

Since the 1800s humankind has achieved magnificent progress thanks to the scientific method and the diffusion of knowledge. Being invested in a stock portfolio is, over the longer term, the same as being invested in human ingenuity and the real economy: you have a stake in the human entrepreneurial spirit, in the new discoveries, in the still unborn ideas. And why does this house chooses to focus on a global basket instead of choosing a single country to specialize in, like most investment houses do? Because we believe ingenuity and inventiveness know no frontiers and we try to keep an eye open for innovation and growth wherever it happens. Through good times and bad.

Does all of this mean that all investors should act the same all the time and not adjust their portfolios according to specific market circumstances? Of course not, like longtime value investors have shown, we can increase our odds of success by being particularly aggressive in our allocation when markets are going through periods of turbulence and a little more defensive when markets are trading at sky-high multiples (the famous “be greedy when others are fearful and fearful when others are greedy” immortalized by Warren Buffet).

So, if an investor is bold enough to enter equity markets when people are particularly fearful and prices are depressed, although these entry points are not indicative for short term performance, it is extremely likely that he will be rewarded in the long run. As the economist Robert Shiller has shown with his 10-year averaged PE multiples study, depressed valuations are not useful to time the market, but practically guarantee an investor will have above average returns if he buys and remains invested for the very long term.

⁹ <https://awealthofcommonsense.com/2022/07/stocks-for-the-long-run/>



Source: <http://www.econ.yale.edu/~shiller/data.htm> , FCL Capital

And what does the Shiller PE tell us right now? That finally after so many years of above average valuations, stocks are, for the first time in a generation, cheap and possibly giving prospective investors above average returns over the very long term. Not many will take advantage of this fact because, as is often the case, there is always something to be afraid of, be it a war, high oil prices, rising interest rates like today or one of the many scary reasons that frightened investors in the past.

Thesis: IHS Towers

As our longtime investors and readers know, this house specializes in searching for neglected opportunities in the most overlooked corners of the global financial markets. In the past, this focus has led to many successful investments in emerging market companies, from a Chinese funeral home to a forgotten Brazilian restaurant chain listed in the US.

In the context of emerging markets, this house has historically focused on two countries in particular: Brazil, due to our local roots and the fact that we are primarily based in the country, allowing us to have unique insights unavailable to major foreign investors; and China, due to our unwavering believe that this century will be molded by the political and economic rise of this Asian giant.

However, the thesis we will be discussing in this letter involves a company primarily located in a country that not even exploring investors like us dared to foray so far, a country that can actually be considered a frontier market, Nigeria.

Despite being the fastest growing continent in the world and demographically the youngest, international investors, this house included, have largely ignored Africa as a potential destination for investments. Naturally, this disinterest has a reason, for decades the continent has been plagued by despotic rulers responsible for some of the most irresponsible and absurd macroeconomic policies in the world.

When we look at the last decades, the democratization and economic progress has been substantial, but what's interesting is that, even if the governance situation in the region is sadly not significantly improved, the continent is still "doomed" to grow due to the sheer number of new people entering its workforce every day. In other words, even with all its problems, Africa's 1,4 billion consumers are not going away, if anything they are actually going to double¹⁰ in the next 30 years and with that they are increasingly going to need more clothes, cars, electricity, and, most importantly for this thesis, more mobile communications coverage and connectivity.

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IHS Towers is a Nigerian company founded in 2001 by Lebanese entrepreneur Sam Darwish, his brother Mohamed and their colleague William Saad (all three of them still lead the business to this day) and was initially a simple builder of telecommunications (telecom) towers for local Mobile Network Operators (MNOs).

As one would expect, to be able to access even the most basic of features in a mobile phone there needs to be a huge telecom infrastructure in place consisting of antennas, cables and, most importantly, towers. And, at the time of IHS' founding, most MNOs still saw telecom towers as a strategic asset and as a way to offer superior services than their competitors through better coverage.

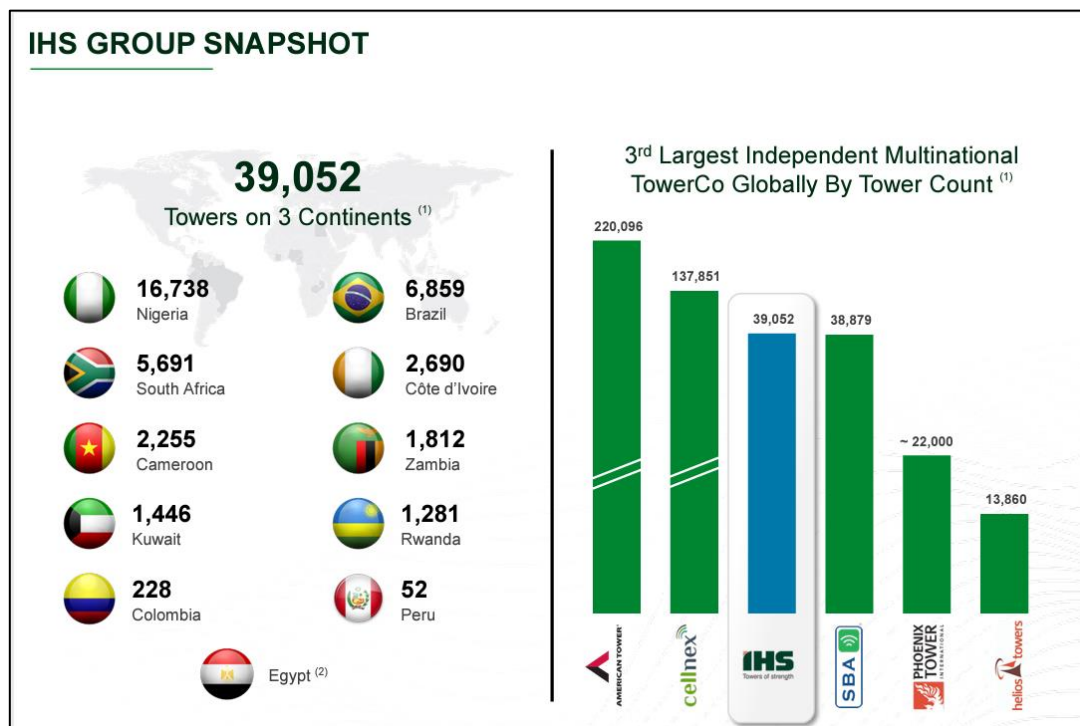
However, unlike in developed markets, operating telecom towers in Nigeria was, and still is, in many ways, similar to a war operation. For starters, the country has effectively no national power grid, which means that each tower requires a complete set of diesel generators and batteries to function properly. In addition, to be able to guarantee the supply of diesel to all towers, there needs to be hundreds of trucks in place to get the fuel to where it is needed, all the while driving through the poor road infrastructure of the country. Not even to mention the constant danger of equipment theft.

Due to all those operational difficulties and costs, MNOs in Nigeria eventually started hiring IHS to perform maintenance, security and power supply services for their towers so that they could focus on their core activities. However, IHS fortunes really started to change in 2009 after it went from operator to owner of towers.

¹⁰ <https://www.economist.com/special-report/2020/03/26/africas-population-will-double-by-2050>

As the sole owner of the tower assets, IHS could lease space on those towers to the MNOs in long term contracts and, therefore, have a recurring and inflation/FX hedged revenue streams. This model proved so successful for the company that after a capital injection from the International Finance Corporation¹¹, global venture capital funds and sovereign wealth funds, it went on a buying spree across Africa and beyond acquiring MNO's tower portfolios and leasing them back to the telecom carriers.

At the time we write this letter, IHS is one of the fastest growing African companies, it owns and operates over 39,000 towers in three continents and ten different countries and, since October 2021, is listed on the NYSE. It is currently the largest independent TowerCo focused exclusively on emerging markets, and the 3rd largest overall by tower count.



Source: IHS 2Q22 Earning's Presentation

To be fair, IHS didn't exactly invent this business model of owning tower infrastructure and leasing it back to wireless voice and data operators. This movement actually traces its roots back to the US in the late 90s, when the so called "TowerCo Revolution" began.

At the time, after years of rampant wireless network expansion throughout the country, major US carriers began to realize that the competitive advantage related to offering greater coverage across different regions had saturated and in turn started turning their focus to other areas of their operations such as customer service and, above all, pricing.

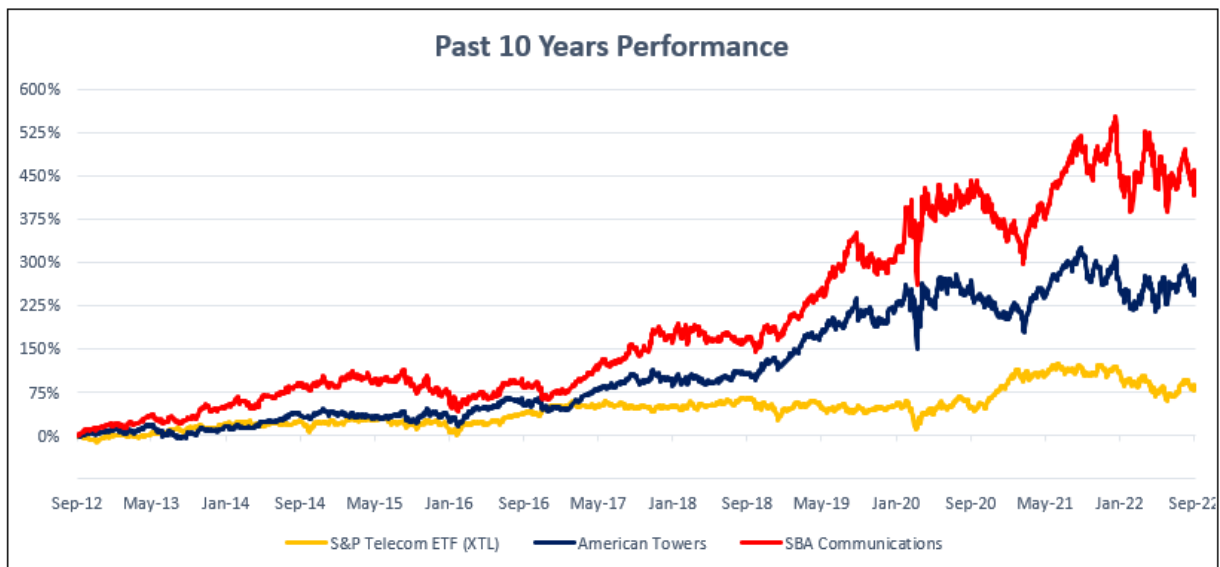
¹¹ Investment arm of the World Bank, responsible for the helping to develop the private sector in third-world countries.

With the ever-increasing pressure to offer cheaper services, MNOs turned to their passive and capex-demanding tower infrastructure as a prime candidate to start cutting costs.

Initially, MNOs attempted towersharing between themselves, but due to a series of factors, mostly related to mutual distrust between the carriers, the initiative never really took off in the US. This created the perfect environment for independent Tower Companies (TowerCos) to enter the market with the proposition of relieving the MNOs of the operational costs related to acquiring land, building and operating tower infrastructure in exchange for a regular fee.

Over time the TowerCo model proved immensely successful and it was in this period that many of the household names of the industry, such as American Towers and SBA Communications were established. The success of the TowerCo business model can be explained by: it's incredibly simple proposition, not having to worry about any of the issues a traditional telecom-related company has to; its absolute resilience to economic cycles; and, above all, by its operational leverage, that is, by adding an additional tenant to an existing tower, the TowerCo has negligible additional costs while essentially doubling its revenue.

This superior economics of the business can be observed when we compare stock performance of the major players of the TowerCo industry to the broader US Telecom Sector.



Source: Bloomberg, FCL Capital


Not long after the TowerCo lease model became dominant in the US, it began to spread to other corners of the globe such as Latin America, Sub Saharan Africa and, more recently, Europe. However, this model is not exactly homogenous. In North America, TowerCos' only responsibility has historically been to provide ground and tower space, while the MNOs are responsible for all the operational components, namely equipment installation, maintenance and power supply (which is not an issue in the region). Due to its simplicity, this particular model became known as "steel and grass".

However, as TowerCos began to expand to emerging markets, the chronic infrastructure and energy problems faced by some countries, such as Nigeria, meant that tower companies had to essentially improve the traditional “steel and grass” model to start providing solutions to many of the operational hurdles faced by local MNOs. It is exactly in this background that IHS began to operate and expand as a tower owner and lessor. In a recent conference¹², IHS CEO, Sam Darwish, provided the perfect explanation for the different mindset between the traditional US-TowerCo model and IHS’ operations:

“Look, I think, most TowerCos think of themselves as a landlord and I get that. I mean, in the developed world, it's largely a real estate play so you are a landlord, per se. We think of ourselves as a service provider. We like to associate ourselves with the need of the carriers as much as we can, for power as a service is one aspect, but it's a suite of things.”

Moreover, there are also some contractual differences between the two models. Just like US TowerCos, IHS typically signs long-term (around ten years) inflation-linked lease agreements with its customers. However, in some of the markets IHS operates, due to macroeconomic uncertainties, some contracts also include dollar or euro linked escalators to protect the company against heavy currency devaluations¹³.

IMPLEMENTING A "DM-LIKE" BUSINESS MODEL IN EMERGING MARKETS



Developed market operating model with exception of power in Africa and FX impacts

	Africa	Middle East	Latam	U.S. Model
Long-term Contracts	✓	✓	✓	✓
Limited Termination Rights	✓	✓	✓	✓
Proxy of US\$ contracts:				
Annual Escalators	✓	✓	✓	✓
FX Resets	✓	✗	✗	N/A
Amendment Revenue	✓	✓	✓	✓
Negligible Multi-Tenant Discounts	✓	✓	✓	✓
High Quality Customers	✓	✓	✓	✓
Power and Land Lease	Fixed Lease Fee	Fixed Lease Fee	Varies	Varies
New Site Strategy	✓	✓	✓	✓
In-Market Acquisition Opportunities	✓	✓	✓	Limited
Adjacent Business Models	Fiber, DAS, Small Cell	Exploring	Fiber, DAS, Small Cell, Edge Data Centers	Fiber, DAS, Small Cell, Data Centers

Main differences between Developed and Emerging Markets TowerCos

Source: IHS 2Q22 Institutional Presentation

¹² https://www.ihtowers.com/investors/investor-presentations-webcasts/2022/goldman_sachs_communicopia_and_technology_conference_webcast

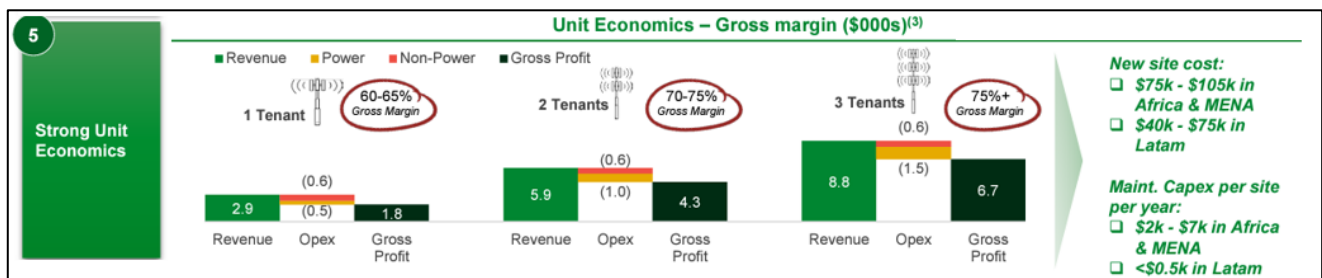
¹³ It's worth mentioning that while the contracts are denominated in USD or EUR, the local carriers pay IHS in local currency, forcing the company to hedge its exposure, mainly to the Nigerian Naira, through non-deliverable forwards.

But above all, just like their US and European counterparts, IHS relies on three main activities:

- Colocation: add additional tenants to existing sites, thus leveraging the existing tower assets;
- Lease Amendments: install additional equipment or perform ancillary services requested by existing tenants;
- New Sites: commission the construction of new Towers to the MNOs specification (build-to-suit).

Naturally, due to its tougher operating environment, IHS has to incur more costs to conduct its business, mainly in relation to diesel. Currently, a staggering 95% of IHS tower sites in Nigeria are not connected to grid and even though the company has been taking significant steps in reducing its diesel consumption (for environmental and economic reasons), just last year it spent roughly 250 million dollars on fuel.

However, this doesn't make the economics of the business any less attractive. As we can see bellow, even with the higher costs associated with energy, as an existing tower manages to add additional tenants, the operating margin significantly improves.



Source: IHS 2Q22 Institutional Presentation

It is quite clear to see that the road to success for IHS rests on three pillars: its ability to increase the colocation rate¹⁴ of its portfolio, all the while building more towers for its customers; be able to acquire additional tower portfolios in other promising markets; and find ways to reduce its diesel consumption in order to increase its operational margin. So far, that's precisely what the company's management has been doing.

Over the past two years, aiming to further decrease its concentrated exposure to Nigeria (roughly responsible for 67% of revenues), IHS has expanded to five new markets, two of which have the potential to be transformational for the company. In 2020, through acquisitions of local TowerCos, IHS entered Brazil, the most promising telecom market in Latin America. It is already the third largest tower player in the region and in 2021 it signed a landmark agreement with local carrier TIM, to form I-Systems, a joint venture in which IHS acquired a controlling interest.

¹⁴ Number of tenants divided by number of towers, also called "tenancy ratio" by other TowerCos

I-Systems includes TIM's secondary fiber network infrastructure, covering approximately 6.4 million houses in Brazil's main cities, and will now be responsible for the deployment of further fiber infrastructure and the operation and maintenance of such infrastructure. This, combined with its already 6.859 (and expanding) towers, means that IHS is extremely well positioned for the impending 5G rollout in the country and we should start seeing promising results in the coming years. It's worth mentioning that the current fiber expansion in Brazil could very well serve as a blueprint for IHS' other markets once they start their own 5G rollout.

More recently, in June 2022, IHS entered the South African market after completing an acquisition and lease back agreement with longtime partner and customer MTN. As part of the deal, IHS acquired 5.701 towers from MTN (thus becoming the largest TowerCo in that market) and will provide power management services to another 7.300 MTN-owned towers across the country. As Africa's most industrialized economy and at the vanguard of the continent's 5G rollout, South Africa is an extremely promising market for IHS. Also, the country is, sadly, starting to have issues with energy supply, which means that IHS' expertise in power solutions will become even more valuable for local MNOs in the future.

It should be noted that typically when IHS enters a new market, it usually does so by acquiring a portfolio of towers from local MNOs (such as the South African acquisition), which means that those portfolios tend to have very low colocation rates initially, close to 1x. In the medium term, it is expected that IHS can increase the number of tenants per tower in those markets, generating huge gains in the process, but in the short term, those recent acquisitions have become the reason for the company's decrease in average colocation rate across all markets.

Colocation Rate	2Q2021	3Q2021	4Q2021	1Q2022	2Q2022
Nigeria	1,49x	1,52x	1,52x	1,52x	1,53x
Sub Saharan Africa	1,79x	1,75x	1,70x	1,70x	1,50x
Latin America	1,21x	1,21x	1,21x	1,28x	1,34x
Kuwait	1,00x	1,00x	1,01x	1,01x	1,01x
Average	1,51x	1,51x	1,50x	1,49x	1,47x

Source: Company's filings, FCL Capital

However, if we decompose the data, we can see that Nigeria, the country IHS has been present the longest and made no recent acquisitions, is slowly but consistently increasing its colocation rate. Overall, the company's towers with over ten years have an average colocation rate of 2,1x and the management sees no reasons why newer tower portfolios can't reach a similar rate. The steady increase in Latin America (mostly Brazil) has also been quite satisfactory and can be explained by increased carrier activity in light of the 5G rollout and by the fact that, unlike in other countries, IHS entered the market by acquiring rival TowerCos as opposed to MNOs-owned towers.

On a different front, IHS is set to announce at the end of this quarter the so called "Project Green", an initiative focused on significantly reducing the company's diesel dependence. The project promises to invest in the implementation of a variety of solutions related the

usage of batteries and renewable energy sources in the tower sites and has the potential, if correctly implemented, to generate material savings to the company in the future and further differentiate IHS from its TowerCos competitors in the region. We look forward to the detailed announcement of the project later this year.

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So, basically, as we've seen so far, we are talking about a company perfectly positioned to surf the ever-increasing digitalization wave in some of the world's most promising telecom markets, with a business model already proved to be highly lucrative and non-cyclical, with contractual protection against macroeconomics risks, still run by its founders and with over ten billion dollars of contracted revenue (not even including the revenue escalators). It would be natural to assume that IHS should be trading at, at least, higher than average multiples, right?

Well...no, as of September 2022, with its roughly 2-billion-dollar market cap, IHS can be considered, by almost any measure, the cheapest TowerCo in the world, and by far. Of course, it is absolutely reasonable that IHS, due to its overexposure to Nigeria and other turbulent emerging markets, should trade at a significant discount to major TowerCos that operate primarily in the US and Europe. But when we compare the company to the other prominent TowerCo operating exclusively in Africa, Helios Towers, IHS is being given an unfair discount in this house's opinion.

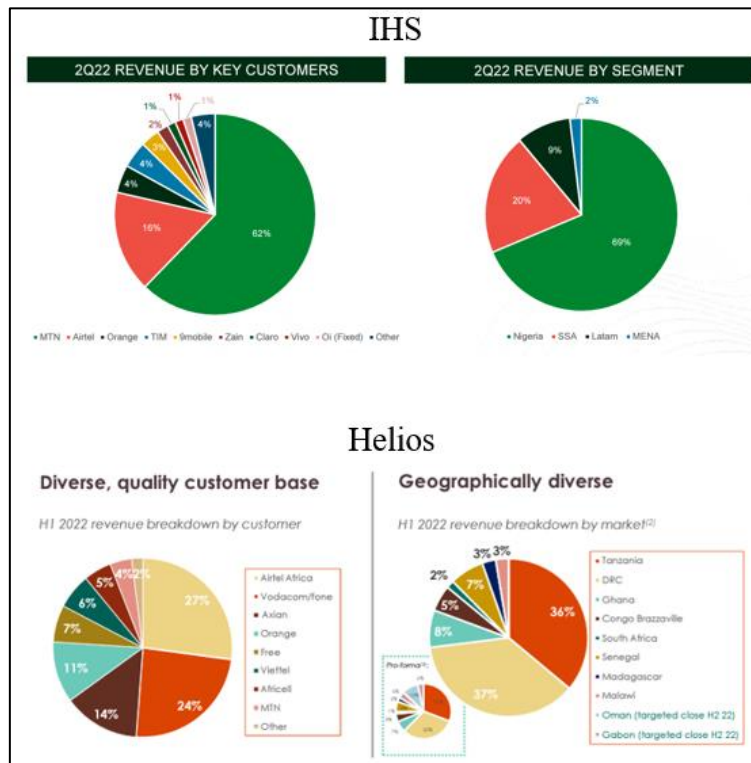
	IHS	Helios	American Towers
# of towers	39.052	14.043	201.077
colocation rate	1,47x	1,7x	2,6x
net leverage	3,1x	3,9x	5,8x
EV/EBITDA (TTM)	5,9x	9,9x	26,8x

Source: Companies' fillings, Bloomberg, FCL Capital

	IHS	Helios
markets	Nigeria, Brazil, Colombia, Peru, Cote d'Ivoire, South Africa, Zambia, Rwanda, Cameroon, Kuwait	Tanzania, DR Congo, Ghana, Senegal, Congo, South Africa, Malawi, Madagascar, Oman, Gabon

Source: Companies' fillings, FCL Capital

Helios Towers is also an emerging market focused TowerCo. It operates in ten different countries around Africa and the Middle East. Despite being nearly three times smaller by tower count than IHS, it has a more diversified customer base and geographical distribution.



Source: Companies' filings

While we acknowledge that IHS is, at the time, overly concentrated, we felt that, overtime, with its recent acquisition activities, Nigeria (although a still very promising market) will become an ever-decreasing part in IHS' revenue pie. We should expect to see Brazil becoming the second most relevant market for the company over the coming years and that is a huge step in the direction of diversifying the company's revenue.

Furthermore, when talking solely about Africa, IHS is, in our view, located in countries with much more potential than Helios. It is already the market leader in Nigeria and South Africa and after its imminent entrance in Egypt¹⁵, the company will become the dominant TowerCo in the continent's three largest economies, home to over 368 million people with still very limited 4G and 5G penetration.

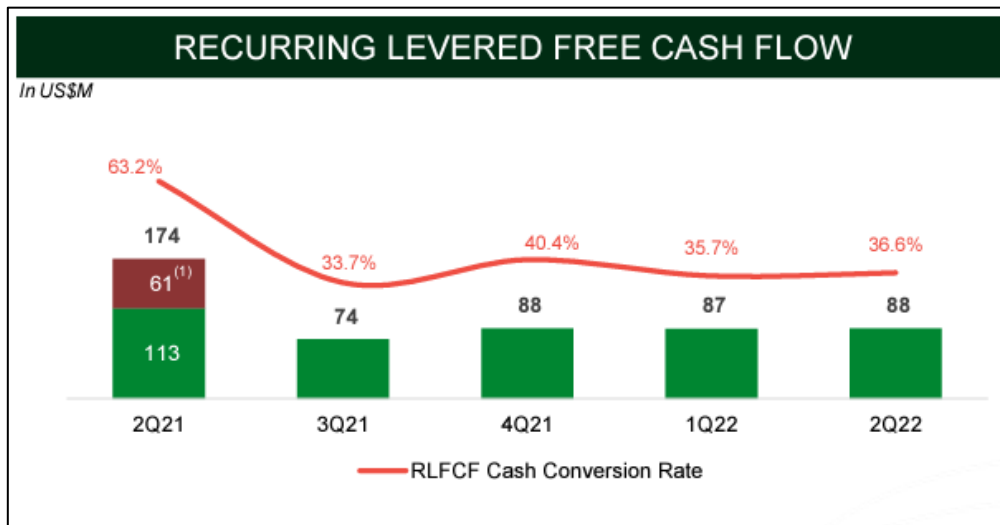
In terms of valuation, the typical acquisition deal involving TowerCos in developing markets ranges between 9x – 10x EV/EBITDA, that's roughly the multiple that Helios Towers trades at the moment. Meanwhile, IHS currently trades at an average 5x multiple, which in our view is unjustifiable for company with better long-term prospects.

Not only is IHS relatively cheaper than its peers, but ever since it became a public company, it has been able to prove itself as a business with highly predictable cash flows. Looking at the company's recurring leverage free cash flow¹⁶ (RLFCF) we can see that,

¹⁵ IHS has already gained regulatory approval to enter the Egyptian market but is yet to start tower construction in the country. Once concluded, IHS will become the first independent TowerCo to operate in the country.

¹⁶ Most used Cash Flow measure in the industry, can be roughly explained as FCFE taking into account only recurring capex, namely tower maintenance.

even when talking about emerging markets, the TowerCo model is non-cyclical and resilient to macroeconomic pressures.



*the steep drop after 2Q21 can be explained by 61M in non-recurring items and higher debt financing and interest costs after the period.

Source: IHS 2Q22 Earning's Presentation

Now, after everything we have seen about the company, a disclaimer is in order. Despite being very excited about IHS's future prospects and confident that its valuation is overly discounted, our position in the company is still very small compared to the usual holdings size of our portfolio. Due to its massive exposure to frontiers markets with many legal risks, we felt that before building a large position, all the possible risks of the thesis had to be completely mapped and analyzed.

Bellow, we list some of our biggest concerns surrounding the thesis and our current assessments thereof.

a. Overall Nigerian Country Risk

IHS has been operating in Nigeria ever since its founding in 2001 and during all these years it has shown incredible resilience to its market. As its often the case with emerging markets, the economic environment is so hostile to local companies that the few ones that survive through many business cycles usually become completely dominant players. Naturally, any political noise coming out of Nigeria (the country's national elections are schedule for February 2023) will affect the price of IHS stock. However, no matter which path the country choses to take, the Nigerian population are increasingly going to demand more and better wireless connectivity and IHS has already solidified its leadership in this market and has proven itself to be more than capable of navigating Nigeria's turbulent waters.

b. Cash Upstream from Nigeria

Recent news¹⁷ about the tight supply of dollars in Nigeria has led many investors to question whether IHS would be able to upstream money out of the country when necessary. In line with our previous assessment, IHS has been upstreaming cash from Nigeria for years, and through many past currency crises. The company has longtime bank partners it calls upon for such transactions and just last quarter, already during the crisis, it was able to upstream 147 million dollars out of the country. Even in a worst case scenario of the company not being able to upstream the cash for a limited time, there would be many “recycling” opportunities for that cash inside Nigeria, such as investments for Project Green.

c. MNO Consolidation

A big risk that any TowerCo faces is the probability of merger of local MNOs which reduce the number of possible colocation opportunities. However, in our view, it seems quite inconceivable that, even in the emerging markets that IHS operates, the local authorities would allow a single carrier to be the dominant telecom provider for a given country. It is expected that in IHS’ most relevant markets (Nigeria, Brazil and South Africa) there will be at least three relevant MNOs, which is more than enough for the company to significantly increase its colocation rate.

d. Overexposure to MTN

The South African-based carrier is currently responsible for over 60% of IHS’ revenue. Should MTN suddenly decide to break its contract, IHS would find itself in a life-threatening situation. However, in the TowerCo business, MNOs are faced with a huge exit barrier because changing a company’s entire wireless infrastructure from one TowerCo to another would demand a great deal of costs and time, during which the carrier’s signal and connectivity would be significantly affected. Therefore, for operational reasons, MNO’s have the incentive to avoid unnecessary changes of tower infrastructure provider and the recent signing of the South African deal with IHS means that MTN intends to keep IHS as an integral part of its network infrastructure for the foreseeable future.

The true risk that needs to be closely monitored is a possible deterioration of MTN’s credit quality which could significantly affect its ability to pay IHS on time. However, at the moment, this is not an issue since MTN is financially healthy and undergoing a restructuring process to further strengthen its balance sheet.

Overall, this house feels confident in IHS’ ability to overcome the many challenges that it faces and believes that most of the risks involved in the thesis are already fully priced in its current market value. Furthermore, the company looks like a perfect name to surf the secular trend of digitalization in the world’s emerging economies.

¹⁷ <https://www.ft.com/content/f69a9464-7f82-472c-95e9-37fb72cac88f>

However, IHS is just celebrating its first anniversary as a listed company and, due to the many risks the thesis involves, we would like to follow it closely for a few more quarters before building a more significant position in the stock.

Should the company prove itself able to consistently improve its colocation ratio, significantly reduce its diesel consumption and further diversify its costumer base and geographical exposure, you can be certain, dear reader, that we'll be talking a lot more about IHS in the coming years.

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Performance

FCL Opportunities	
Year to Date, 2022, in BRL	-32,47%
Year to Date, 2022, in USD	-30,50%
12 Months, in BRL	-33,52%
12 Months, in USD	-33,17%
MSCI All Country Index, 12 Months, in USD	-20,66%
Since Inception (30/01/2017), in BRL	76,35%
Since Inception (30/01/2017), in USD	1,51%
Avg Annual Return, since inception, in BRL	10,35%
Avg Annual Return, since inception, in USD	0,26%

At the end of the quarter, FCL Opportunities top 5 positions were:

Position	Country	% Fund NAV
Go Daddy	USA	13,6%
Capri Holdings	USA	12,4%
Fleury	Brazil	9,6%
Entain	UK	9,3%
Moncler	Italy	8,4%

FCL Opportunities Portfolio Composition on September 30th, 2022:

Portfolio Composition by Sector	
Consumer Discretionary	39,2%
Technology	25,9%
Healthcare	13,3%
Education	7,9%
Financials	5,6%
Industrials	3,6%
Telecom Services	0,9%
Basic Materials	0,6%

Currency Exposure	
USD	36,4%
BRL	26,9%
EUR	15,3%
GBP	9,3%
HKD	7,0%
CNY	4,2%
INR	0,9%

Geographic Distribution	
USA	31,9%
Europe	25,9%
Brazil	25,2%
China	11,2%
India	1,8%
Nigeria	0,9%

Portfolio Concentration	
Top 5	53,3%
Top 10	82,1%
Top 15	94,5%

FCL Opportunities had a disappointing performance so far in the year of 2022. Year to date on September 30th, 2022, the fund had a negative performance of -30,50% in US dollars (-32,47% in Brazilian real) compared to -24,77% of the S&P500, -32,40% of the Nasdaq index and -26,42% of the MSCI All Country World index.

Granted, over the longer term this house focus is surpassing all the major equity indexes and throughout most of our history we have managed to fulfill that task, taking advantage of investment opportunities other houses are unable or unwilling to be a part of. That said, this very focus of having investment ideas that are sometimes out of consensus makes us underperform from time to time.

Like we discussed previously, investing is a cyclical business and a confluence of factors (already discussed in this space) came together to make 2022 an annus horribilis.

While we won't call our fund's performance a catastrophe, since all it did this year was basically fall in line with the major global equity indexes like the S&P500, Nasdaq or the MSCI All Country index, there's no denying the fact that the terrible results these indexes themselves suffered made our own performance very disappointing and not on par with this houses own expectations.

The reasons for this drawdown were discussed in great length in the performance section of our 2Q2022 letter¹⁸ and the good news, like we said at the time, is that we implemented

¹⁸ https://8d6b179e-dfa9-4146-86f7-763a65725bc5.usrfiles.com/ugd/8d6b17_c4d1157fefaf441db9a3eb089b429992.pdf

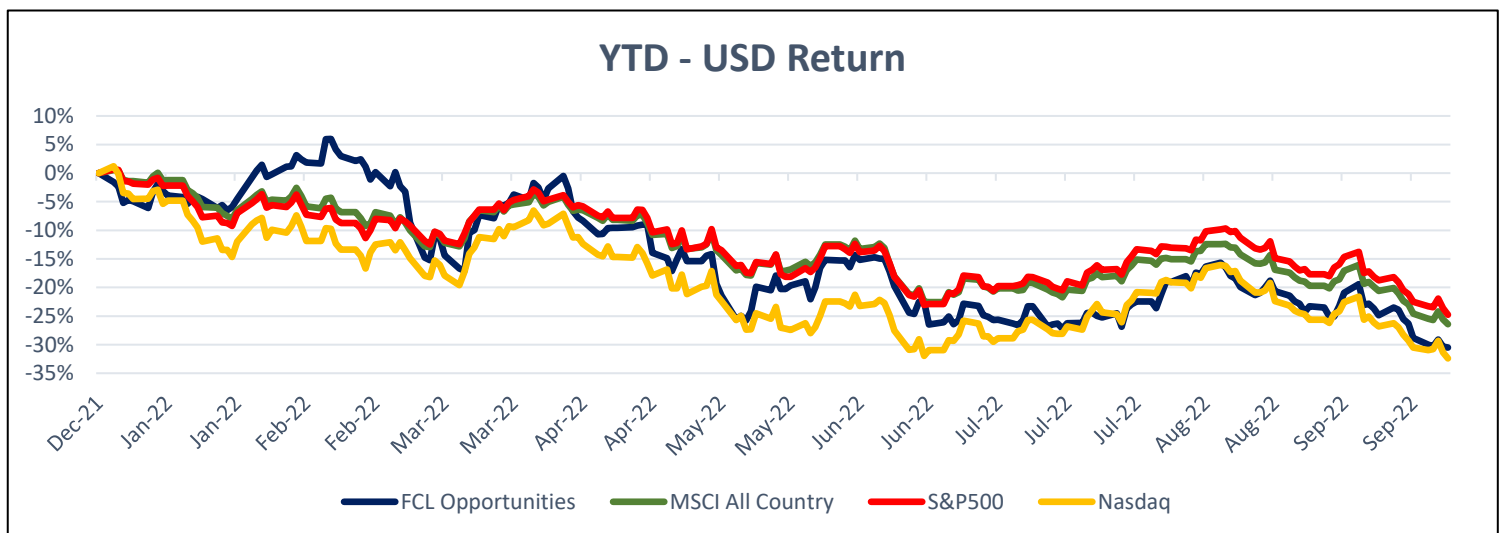
a range of initiatives, some of them already bearing fruit, especially when it comes to internal processes like portfolio management and risk control procedures. Every market crisis brings lots of lessons for those eager to continue learning and this house certainly belongs in this camp. We have and still are learning a lot from this disappointing year, you can be sure of that.

As a reminder, over the past year we:

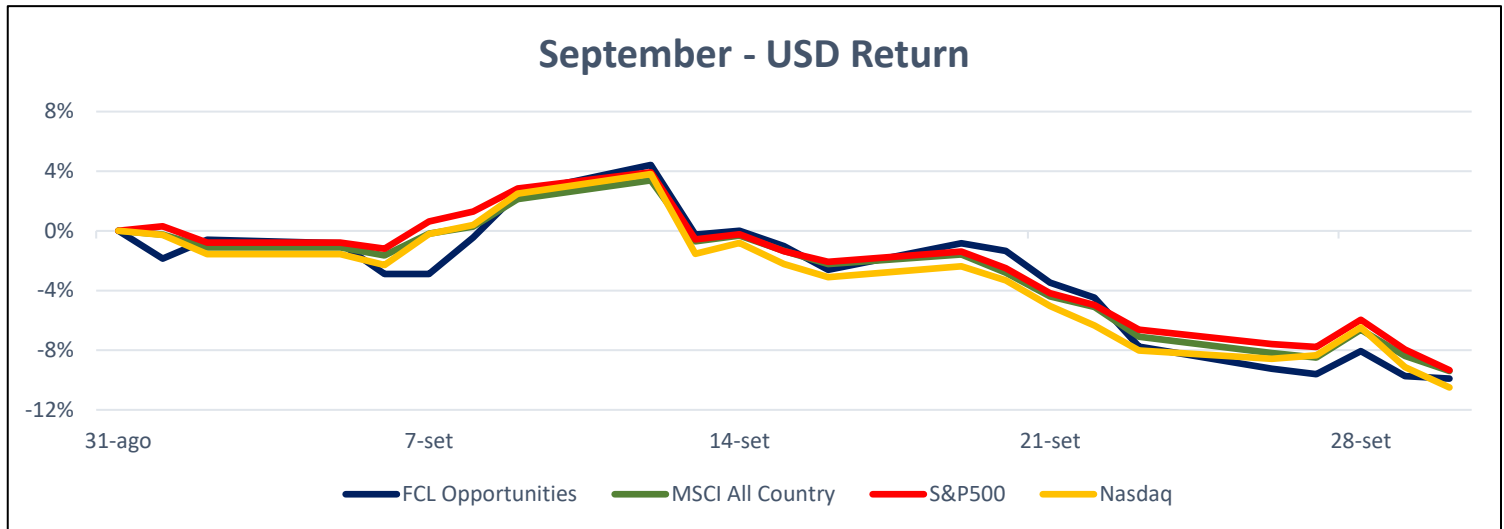
- Implemented a more robust risk committee, overseen by one of our partners, which has the sole task of monitoring all risks our fund might be incurring and to take initiatives to mitigate them;
- Extinguished our FCL Hedge fund, so that we could solely focus on finding global investments opportunities in the most frontier, overlooked and promising markets, in ways that no other investment house in Brazil and few other in the world do.

We are very confident that these initiatives are already starting to enhance our performance and will continue to do so even more in the future.

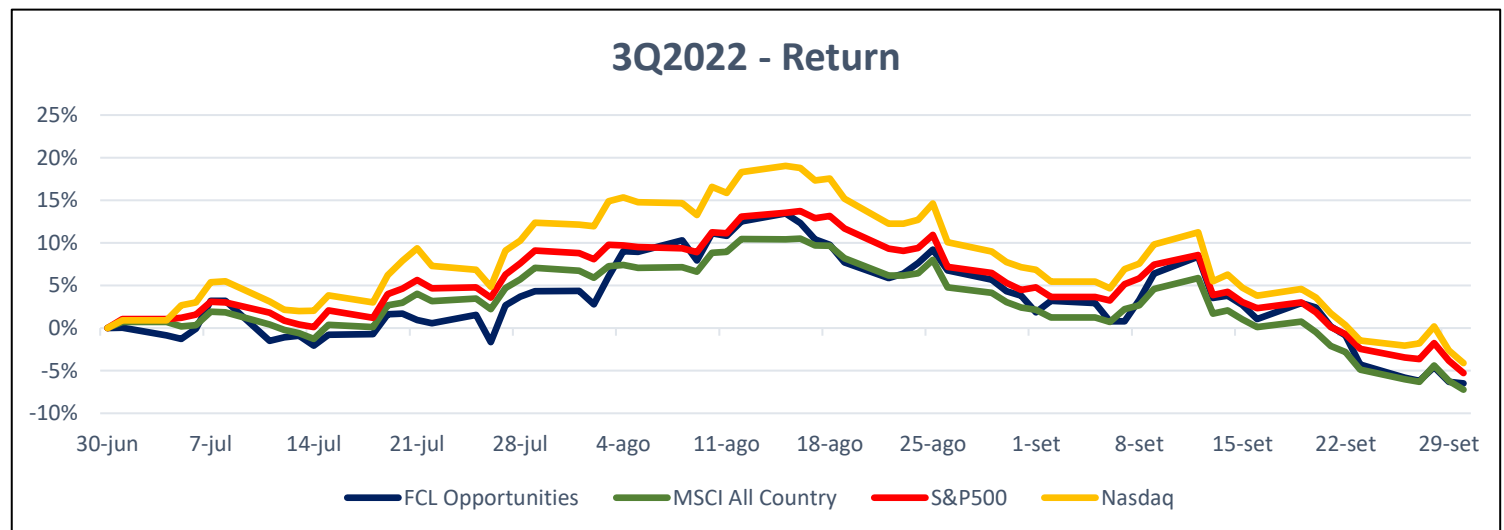
It is important to remember, since we are roughly in line with major global stock indexes (Brazil's Ibovespa not being one of them and not constituting a major part of our portfolio), we note that we did have worst years on a relative basis in the past, for example years when our fund had a 10% positive return when compared with a 15% positive return from the MSCI All Country Index, thus trailing the index by five points. But this is of little consolation: for most of our investors, as this house is aware, relative performance only counts on the way up, not on the way down and of course our goal is absolute positive compounded performance that will, we hope, be superior to most global stock indexes over the long term.



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Source: Bloomberg, FCL Capital

As a usual reminder, the most important indicator with which we evaluate ourselves is compounded annual return. Since inception, our FCL Opportunities had a positive annual return of 10,35% in Brazilian reais and 0,26% in US Dollars (we will explain in greater detail the reasons behind the USD performance in the following paragraphs). Over time, the fund's objective is having compounded annual returns close to 20%, with the fund achieving higher marks than that after major bull markets and then reverting back to annual returns in the 10% - 15% area after market corrections like the one we experienced in the past 12 months. While there are certainly no guarantees or promises, a compounded annual return in the 15 - 20% camp while in a neutral cycle would be a target for us.

As we mentioned in the first section of this letter, it is always very hard to predict what stock markets are going to do next. Long term valuation models, like the Shiller PE index, are a good guide for what should happen in the next 10 to 20 years for the markets (depressed valuations usually lead to above average returns in the next decade or so while

the inverse is also true), but there are not methods in widespread use that are useful for predicting short term stock returns.

And how are global markets behaving today? The honest answer is that some corners of stock markets are clearly showing once in a lifetime investment opportunities.

Major tech companies experienced equity price falls in the 50% - 80% magnitude while continuing to show increasing profits and promising prospects. Just to state one major example, recently it came to our attention that the Hang Sang Index is trading at its lowest valuation ever on a price to book ratio¹⁹.



Source: Bloomberg, FCL Capital

Notice just how times change and how markets behave, with its eternal dance between greed and fear: At the beginning of the century, Chinese stocks were going up when the world first realized the opportunities and possibilities of investing in this major country, and after a few years, euphoria took place and the index went through a bubble in 2007, with the price to book ratio rising to nearly 3.5 times. Then, more recently, due to extreme pessimism in global markets and country specific factors (already discussed in great lengths in our previous publications), the ratio fell to just 0.6, its lowest reading ever and less than half its average since the beginning of the century. In other words, the index would have to more than double only to get back to its historical average valuation and, to reach its 2007 levels, a rise of more than five times is necessary.

Of course, there are no certainties in this eternally probabilistic activity that is investing and no one knows for sure if whatever is invested now will bear fruits in the future. Such promise can never be made.

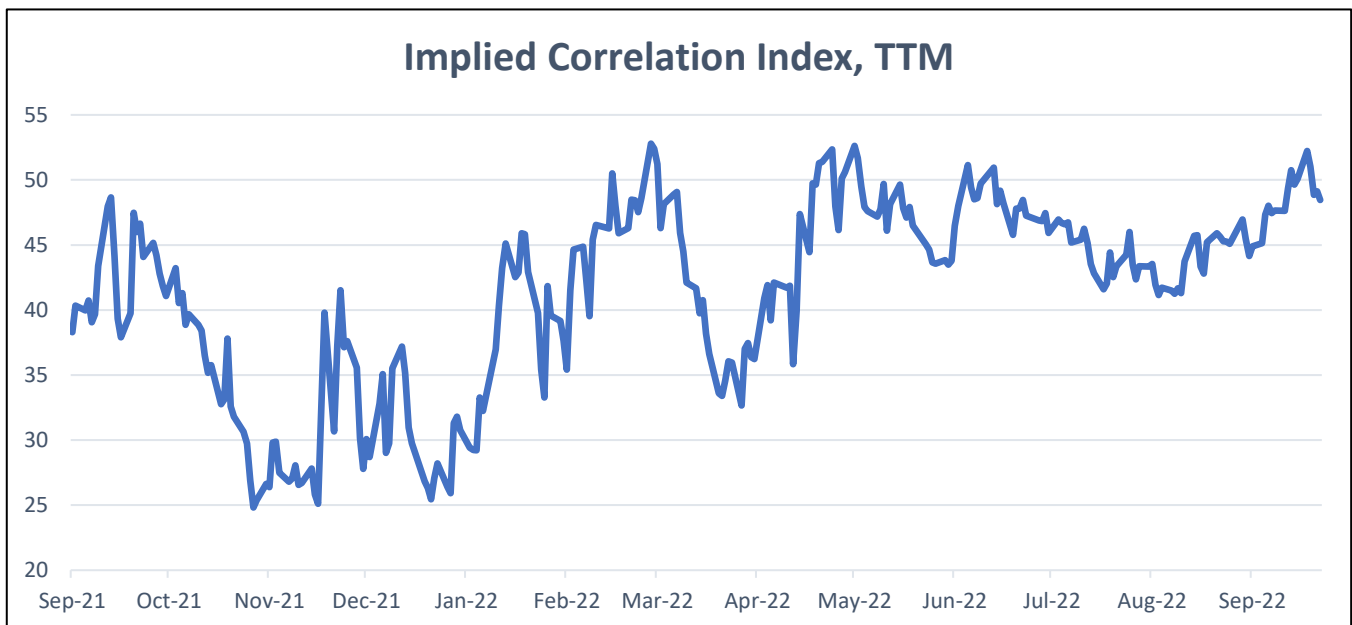
But what we can state with confidence is that:

¹⁹ <https://www.bloomberg.com/news/articles/2022-09-30/china-shares-plunge-to-lowest-valuation-on-record-in-hong-kong>

After many years of above average valuations, about which we discussed many times in this space, global stock markets finally are trading at multiples well below their long-term averages, if not in aggregate at least for some major pockets of those markets.

Some countries and sectors definitely were more penalized than others in the global selloff and, in our opinion, some crazy movements happened. This might be, this house speculates, a consequence of the rise in trend following funds and instruments that lead to a situation of “risk on” and “risk off” days when almost everything rises or falls in tandem.

Indeed, unlike in prior times when a few days of falls would lead to “bargain hunters” in the markets, nowadays the herd sometimes seems unstoppable, leading to amplified movements that last longer: down days with monumental losses, up days when everything flashes green and short sellers have to cover their positions.



Source: Bloomberg, FCL Capital

The consequence is that movements go to extremes more often and for a longer time than in the past, but reversals, as always, still occur. Over the longer term this does not make much of a difference, but in a particular quarter or year, it makes a hell of a difference.

So as always we change our portfolio according to circumstances looking for the most promising opportunities. Currently, our FCL Opportunities fund is overweight in consumer cyclicals, technology, Brazilian and emerging markets equities, while being underweight commodities and staples.

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Thoughts on performance measurement in a record US dollar environment

It is never our aim to give excuses for our performance. We always try to make this section of our letters the most transparent, informative and self-explanatory as possible for our investors to judge our performance and our thought process. In addition, once again we state in an upfront way that, as we just discussed above, this house judges that its own performance was not on par with what our investors have come to expect from us over the years. As we take a deep look inside in many of our processes and in our strategy, we came to the assessment that some of our risk control procedures clearly needed more robust controls and left to be desired.

That being said, it is also important to note that optics, that is, how our performance is measured, is very important to get the full picture.

First, when compared to the most important benchmarks, the S&P500, the Nasdaq and MSCI All Country index, our fund performance suffered similar losses, which is bad, given the terrible performances of these indexes, but certainly not uniquely catastrophic.

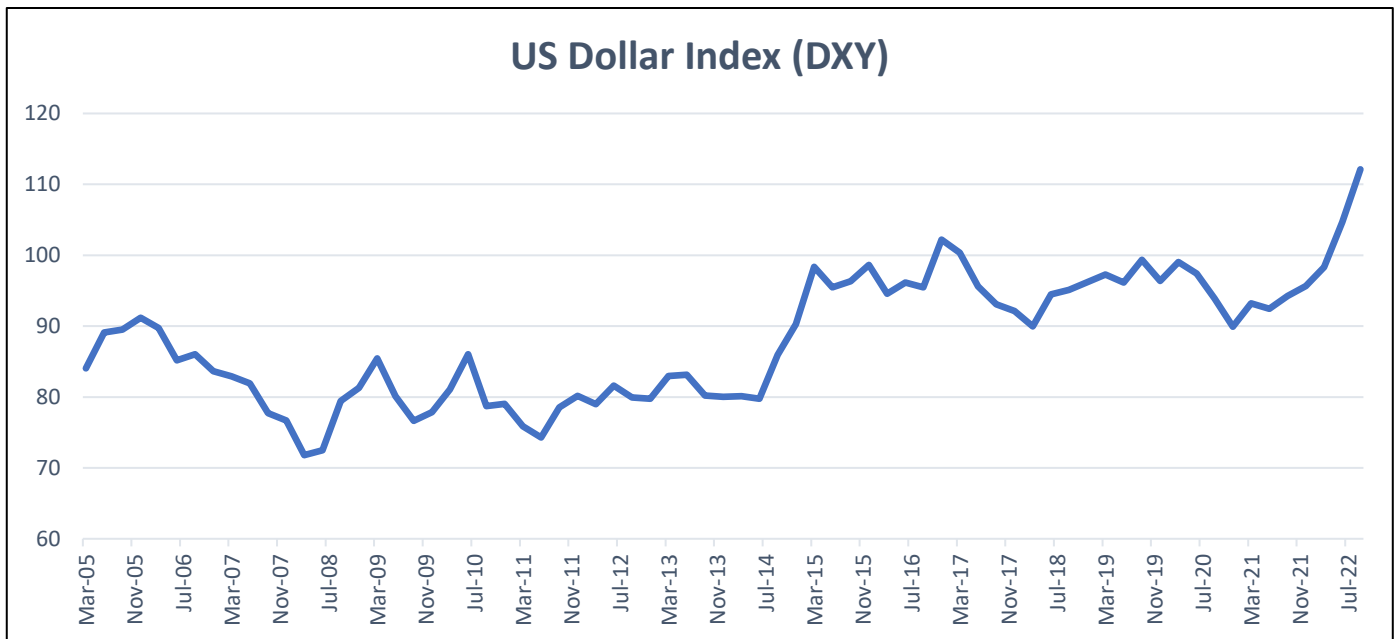
But even more important is the effect of currencies movements around the world we simply cannot control.

As our investors know, FCL Opportunities performance is made of two components:

- The positive or negative returns and dividends of the securities we invest in;
- The currency translation of these investments back to US dollars and Brazilian reais, the two currencies most of our investors measure our performance in.

In other words, if we choose a security in the Euro zone that has appreciated 10% in price in its own currency, but the Euro depreciates roughly 20% against the US dollar (as has been the case this past year), the result is a 10% loss when measured in US dollars.

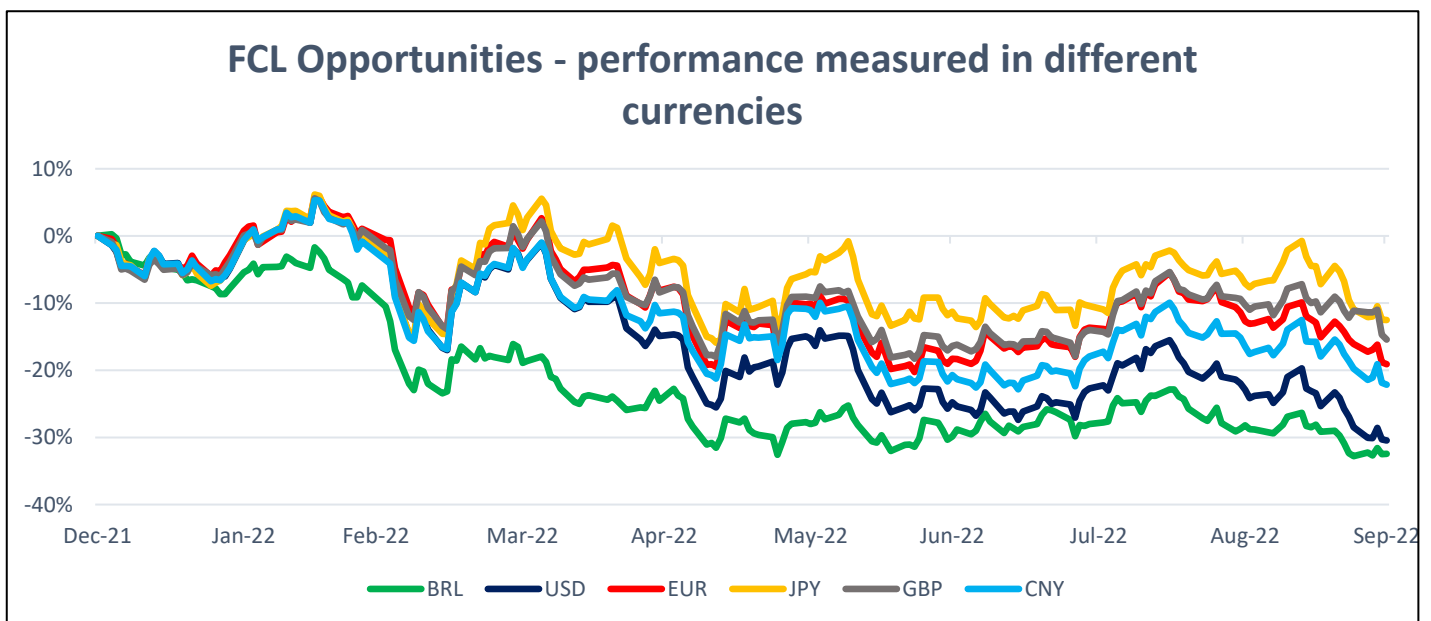
The year of 2022 brought not only some of the biggest stock market losses of the past 20 years but also a record high for the US dollar when compared to other major world currencies (they usually go hand in hand because the US dollar tends to go up when risk aversion rises).



*The index goes up when the USD gains strength.

Source: Bloomberg, FCL Capital

So, as an intellectual exercise, let's measure our FCL Opportunities performance against several other currencies in 2022:



Source: Bloomberg, FCL Capital

We wanted to pick several different currencies so that we don't get accused of deliberately picking the one that enhances our performance the most. But the thing is, as we can see from the charts, there was in fact, one currency that held up against the dollar, one currency that appreciated to the point that investors measuring global (and our fund!)

returns in that currency suffered as big nominal losses as US investors using the US dollar: precisely the Brazilian real. So it is no overstatement to say that over this past year an investor in, say, France or Japan, felt less unhappy about global equity returns than an American or Brazilian one.

Therefore, for Brazilian investors, unlike past years when the Real depreciation acted as a shock absorber for our fund (when measured in BRL), this year the exact reverse happened, the Real appreciation amplified our fund's losses measured in that currency. In tandem, fixed income didn't offer shelter for investors as it usually does, since, amazingly, global bonds also experienced a major fall in prices this year.

To sum it up, it was a risk off year, with a major bear market in global stocks that was exacerbated by the highest US dollar in 35 years, which soared against all other currencies. Meanwhile, pretty much all other asset classes also suffered severe price drops, especially against the US dollar and the Brazilian real: bonds, cryptocurrencies, you name it.

So if everything fell against the US dollar and fixed income didn't serve as a proper hedge what could, in retrospect, an investor have done in 2022 if he had tomorrow's newspaper?

The answer is that he should have, quite simply, stoked US dollars inside his mattress and slept for a year. An anomalous situation that, we are sure, won't last long and we suspect might reverse in the future, with global stocks recouping at least some of those losses and the US dollar, over the longer-term, reverting back to its average historical levels.

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Attracting talent

To end on a more cheerful note: this house is, as always, committed to finding the best and brightest talent in the global investment industry to create the way forward for global investing with disregard to borders (be it physical as in only investing in a single place or mental as in only looking at a particular asset class or situation).

If you share this mindset, email us at info@fclcapital.com.

Our unique proposition, we think and hope, will continue to attract talented analysts and prospective partners to our house to help in our mission of trying to understand the world, the frontiers of global investment management and looking for investment opportunities neglected by most global investors.

And even more importantly, if you believe in us, think this investment philosophy can lead to superior long term risk adjusted returns in this globalized 21st century, and you are an investor, be it an endowment or just an individual looking for non-correlated investment ideas to put in your portfolio, you can look at how to invest in our fund at www.fclcapital.com/how-to-invest

It is thanks to you all, our investors and friends, that we keep doing what we do. As always, thank you for your support and partnership.