September 24, 2024

Friend/Owner,

This was the performance of the funds in the first half of 2024:

	Conviction	Resilience	Focus
Profitability 1H24	7,20%	0,55%	4,81%
Price 09/24	60	134	36
Estimated value 09/24	178	236	110
Difference	197%	76%	206%

Potential 5 years annualized	
Focus →	>20%
Conviction →	15-20%
Resilience →	10-15%

The most difficult

You enter your Owner area. Your position is 30% below what you invested a year ago. The first thing you think is *"these Rolnik guys don't know what they are doing... why did I invest if I don't know anything about this?... I had already been told that the stock market is a lottery*".

When you invest in listed companies, **the hardest thing to do** is to ignore short-term (less than 5 years) price movements and **focus on the evolution of value**. In the long term, price and value go hand in hand, but in the short term they can be very different.

This is the main reason why, **although the stock market always goes up in the long term, not everyone makes money investing** in it. The problem is that, if you don't have a reference of what the value of what you have is, it is difficult to evaluate how your investment is doing beyond what the price has moved. Unfortunately, that value is a figure that does not appear anywhere.

What does appear everywhere is the price and that is what we tend to focus on. It happens to me sometimes too, and I've been doing this for a long time. When the price of one of our companies goes up 40% in one day (like Clearpoint last August 8), the first emotion is "*it's worth 40% more than yesterday*". I have to remind myself that **what the price does one day or one month or one year doesn't matter**. At best it can become a buying or selling opportunity, but nothing more. **It has no necessary correlation to the performance of the stock**.

A company's value evolves much more progressively every day as it improves its product, provides good service to its customers, expands its markets, hires talent, polishes its culture, etc. In short, every time it improves in order to sell more and earn more.

Let's take a good company that grows in value by 15% from one year to the next. This would be equivalent to a 0.056% increase every day of the 250 trading days per year. Now imagine a unique company that has **created a lot of value and is worth 40% more** from one year to the next. **It would** still **have to rise 0.135% per day**. This contrasts with daily movements of 3-5% that are normal and even 15-20% that happen so often that no one is surprised.

People's opinions and emotions vary much more than the value of companies. The good news is that, thanks to that difference, there will always be opportunities to buy extraordinary companies at good prices.

An example of this is what happened in Ken Heebner's CGM fund. It was the best U.S. mutual fund in the decade 2000-2009. **The fund achieved a return of 18% per year in** a period when the U.S. stock market gave negative returns. The incredible thing is that **the average investor in this fund lost 11% annually**.

How can it be explained that the average investor had a return 30% lower than that of the fund in which he invested? The answer is the human tendency to buy something when it has gone up and sell when it has gone down. Although it is **obvious that something has less risk and more potential when its price is lower**, people can't help themselves.

This is all well and good and we have discussed it several times, but how do we solve it? **We have included in the table what we think our funds are worth together with their price**. This means that if the market is offering you €1,000 for your Conviction position, we think it is worth €3,000, even if the market is not offering you that right now. What you are offered at a given moment does not necessarily have to match the value. It's similar to if you have a house for sale and you don't get any offers. You wouldn't think its value is zero simply because that's what you're being offered at the time. It's a matter of time before the market makes you an offer that reflects its value. It also means that what you are investing now you are buying at a 66% discount.

Most funds do not give their estimate of what they think it is worth for fear of putting a figure on it and not having it come true after a while. The price paid for avoiding this is that **the investor does not know the difference between the value and the price** of his investment at any given moment. As he does not have a reference, he does not know when is the best time to invest more.

At Rolnik we help you multiply your resources by choosing for you the best companies in the world and the best times to buy and sell. But **much of the work of this multiplication is done by you**, saving, investing recurrently, holding on in the falls (and ideally investing more) and being patient for years so that the multiplication is exponential.

So, although we run the risk of sounding too salesy by putting the value we estimate, we include it because **we think it is necessary for you to have a reference of the value of your investment**, not just the price you are offered for it.

In the end, what is investing well if not buying something when it is worth more than its price?

They attack us

We are used to thinking of investing as **buying something for less than it is worth and waiting for it to go up**. When you invest in listed companies, the opposite is also possible.

If you think a company is expensive and worth less than its price, **you can borrow its shares at** an interest rate and sell them in the market. Since you have to pay them back in the future, if the price eventually drops as you thought it would, you can buy them back for less than you sold them for and your profit will be the difference.

There are funds that invest all or part of their portfolio in this way. **They usually make public their thesis** explaining the reasons why they think the company is overvalued. They perform useful functions for the market in regulating excesses and uncovering fraud. They also serve investors as a countermeasure to cushion general downturns.

There are two drawbacks to this type of investment. The first **is that the stock market always goes up in the long term**, so you are swimming against the tide. The second is that **the profit potential is limited** because, at most, the stock price can go down to zero. In that case, your profit will be what you borrowed and sold, which you no longer have to pay back. But **your loss potential is infinite**, since there is no ceiling on how high a stock can go. One of the best-known bearish investors responds to this with *"I've seen more companies go to zero than to infinity."* True.

There is a third criticism, more ethical than anything else, and that is that they **do not need what they say negative about a company to be true**. If they sow doubt, the market will panic, people will sell, the price will fall and they will be able to *cover* their position (buy back the shares they sold in order to return them) with a profit.

The incentive is perverse. By finding a company where you can sow doubt, it's a matter of accusing them of things that are unprovable and difficult for the average investor to evaluate, and they should be able to make money.

This is what has recently happened to two of our companies, Dlocal and Eurofins Scientific. Coincidentally, the attack was made by the same bearish fund, **Muddy Waters (MW).**

MW has had successes in the past such as discovering in 2010-2011 that several Chinese companies that went public in the US were **frauds**, or his thesis on the French supermarket chain **Casino**, which has ended up going bankrupt this year after being overly indebted for years. They published their thesis on Casino at the end of 2015 and it has ended up going bankrupt 8.5 years later. **When you invest in companies, whether upside or downside, you have to be patient**.

They have also had **mistakes** such as betting against the American telecommunications tower company **American Tower** (16% annualized return since they went public in 2013), the Chinese sportswear company **Anta Sports** or the medical companies **Chinook Therapeutics** and **St Jude Medical** which were acquired by the pharmaceutical giants Novartis and Abbott.

The bearish report on Dlocal (DLO, in **Conviction** and **Focus**) was issued in November 2022. The impact was immediate, with the price dropping more than 50% in one day. The allegations focused on accounting details that are easily explained by the complex structure of a company that **facilitates payments to 700 multinationals in more than 40 emerging countries**.

DLO's response was late and not very forceful. The reality was that the company had grown too fast, there was some disorganization, and the young management team was not prepared to scale the company.

Founder and reference shareholder **Sergio Fogel** (17% of shares) has already acted, reinforcing the management team with 3 top executives. **Mark Ortiz** as CFO (GE Capital), **Carlos Menéndez** as COO (Mastercard, Citi) and **Pedro Arnt** as CEO.

Pedro has worked at MercadoLibre, which we own through the 3 funds, since its inception in 1999. For the last 12 years he has been its CFO. In these 25 years, he has earned a **reputation as an extraordinary executive**, so much so that the stock rose 61% the week his hiring was announced.

DLO is now in a strong investment momentum to continue to expand markets, so its profit margins have declined in recent quarters. This has caused the price to fall again, giving us the opportunity to buy more shares at even better prices than when the bearish report came out. We estimate that the company **is worth 3 times its current price**. Meanwhile, DLO **continues to increase in value** at rates approaching 30% per year.

Eurofins Scientific (ERF) is the other company we have (**Resilience** and **Focus**) that has been targeted by MW. ERF is a **world leader in laboratory testing** including food and livestock testing, environmental, pharmaceutical, clinical diagnostics and consumer product testing.

In this case the attack has been surprising because ERF has been **one of the best companies to invest in over the past 25 years**. It has achieved an annualized return of 24% since its IPO. 10,000 invested at its IPO in October 1997 is now $3,062,000. **Investing in good companies and being patient has a great reward**.

MW's main attack revolves around the fact that **Gilles Martin**, founder and major shareholder with 33% of the shares, owns some of the real estate where ERF has its laboratories.

When ERF invests in a laboratory, refurbishing it and buying machinery, they need to have the property *under control*. If this is not the case and the owner does not want to renew the contract when it expires, they have to change location, losing the investment. Historically, **ERF has preferred not to own the real estate so as not to have captive capital with low returns** (in the real estate market it is difficult to obtain returns higher than 5-7%).

Even if the current formula is the best economically for ERF, it is true that transactions between listed companies and their reference shareholders do not give the best image. It is easy for a bearish investor to make them look unfair to minority shareholders. The solution Martin has proposed is for **the remaining shareholders** to **decide whether it is better for ERF to acquire the properties** from Martin's holding company or not.

ERF had a strong growth during Covid (many tests were done in their laboratories) that in the last 2 years has disappeared and they have had to replace those sales with others. After these two years of slowdown, in which they have also not made many acquisitions with which they have traditionally grown, it is very likely that they will return to good growth in the coming years. We estimate that **the value of the company is twice the price at which it is trading**.

In any case, we thank Muddy Waters for making people who had no confidence in DLocal and Eurofins hesitate by giving us the opportunity to buy his shares at a **deep discount to what we estimate them to be worth.**

Save, multiply, wait and enjoy.

Jaime Carrasco Houston
CEO/CIO