

Annual ricapitolare

2022

“Character: the virtue of hard times.”

Charles de Gaulle.

@ConserValue

3 January 2023



The year in review.

Last year evolved as a great opportunity to learn about life and investing. I met wonderful people who have added a lot of value to my circle of competence and fostered my personal development as a private investor. A special mention is due to Gustavo (Twitter account @MexicanInvestor), to whom I feel very grateful for all the open discussions and honesty. I have come to consider him a friend.

In retrospective, creating the @ConserValue account has resulted in a surprising success: it has been -and continues to be- a key driver of personal development at various levels.

My vision for this account is to be a humble guide for any new comer to the stock market (as I consider myself to be) who is eager in the search of information, hopefully helping them by filtering noise out and gathering what I believe has contributed most in my initial steps as a private investor.

On the personal side, I completed my MSc studies in Industrial Engineering in July which, combined with my job, sometimes made it challenging to devote all the time I would like to writing down learnings and thoughts.

New freed time has been extremely welcomed in the second half of the year.

Market performance.

The portfolio returned -4.53% for the full year, negatively impacted by the increase in purchasing power of the euro in the last months (detracting -1.00%), which equates to -3.53% at constant currency.

The S&P500 non-financials (SPXN) returned -13.89% in EUR terms over the same period, partly offset by currency fluctuations (USD/EUR lifted +6.04%), leaving its returns for the full year at -19.93% at constant currency.

The added value in market quotations of the companies in the portfolio (when compared to the aforementioned benchmark) has therefore been +9.36% in EUR or +16.40% at constant currency in 2022.

In my opinion, the average investor would fare best focusing on the things that are under our control.

Currency fluctuations are just not one of them.

The top contributors to market performance last year were O'Reilly Automotive (+1.78%), Games Workshop (+1.74%) and LVMH (+1.66%).

The top detractors were Temenos (-4.52%), Meta Platforms (-3.43%) and Adobe (-1.37%).

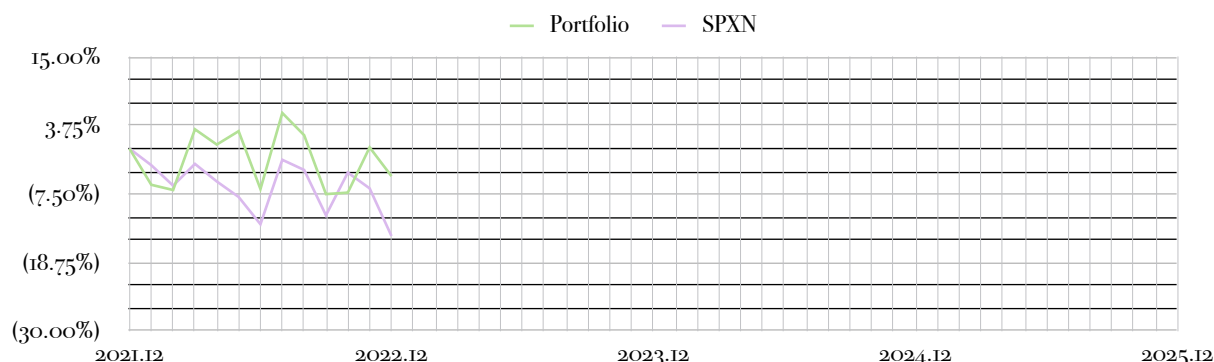
PORTFOLIO RETURNS

Period	Portfolio*	SPXN*	Delta*	Currency fluctuations		Portfolio**	SPXN**	Delta**
				Portfolio***	USD/EUR			
2022	(4.53%)	(13.89%)	9.36%	(1.00%)	6.04%	(3.53%)	(19.93%)	16.40%
2023	35.15%	15.92%	19.23%	(0.35%)	(4.30%)	35.50%	20.22%	15.28%
Cumulative	29.03%	(0.18%)	29.21%	(1.35%)	1.48%	30.72%	(3.74%)	34.46%
Annualised	13.59%	(0.09%)	13.67%	(0.68%)	0.74%	14.33%	(1.89%)	15.96%

*Green: market performance (incl. dividends), adjusted to EUR.

**Yellow: market performance (incl. dividends) without the effect of currency.

***Weighted impact of holdings' currencies, adjusted to EUR.



Owner's earnings.

I do not see stocks as a trading vehicle but as a real piece of a company. Thus I feel the obligation to behave as an owner of the businesses I invest in.

It seems natural then to study their underlying economics, the growth and quality of their earnings and their long-term prospects.

Over sufficiently long periods of time, market quotations tend to reflect the value of the companies they represent. As of this year, I will submit a table showing the growth of the intrinsic value of the companies in the portfolio -measured as EPS growth plus dividend yield- and how it compares to market performance (resembling the idea created by Warren Buffett and cloning its flawless application by François Rochon at Giverny Capital: owner's earnings).

The case of Temenos may result surprising at first glance but, as addressed last year, the company is transitioning its on-premise offerings to a subscription-based pricing model. This should impact cash flows in the short term.

Both ASML and Temenos cases come to my mind as similar businesses in comparable situations: both operate in cyclical sectors but, as usual, the devil is in the details and there are nuances which make these businesses non-cyclical.

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OWNER'S EARNINGS

Period	Portfolio			S&P500 ex-financials		
	Intrinsic value*	Market**	Delta	Intrinsic value*	Market**	Delta
2022	9.12%	(3.53%)	(12.65%)	10.39%	(19.93%)	(30.32%)
Total	9.12%	(3.53%)	(12.65%)	10.39%	(19.93%)	(30.32%)
Annualised	9.12%	(3.53%)	(12.65%)	10.39%	(19.93%)	(30.32%)

*Owner's earnings growth, measured in EPS growth plus dividend yield.

**Market performance, including dividends and without currency fluctuations.

The field denominated as "Intrinsic value" in the table above derives from a weighted calculation of the individual growth rates of the companies owned at year end, defined as EPS growth plus dividends.

The table in page 4 provides a more detailed of these values.

Some companies did not perform well due to a variety of reasons which are addressed (to the best of my knowledge) below, while others had outstanding performance given the current environment.

In the digital advertising space (Dotdigital and Meta), it looks like that the entire sector was effectively over-earning during the pandemic.

Particularly, Meta Platforms entered the year with a 2021's growth of more than 40.0%, making their comparable sales year-over-year difficult to beat as restrictions eased completely in most Western countries in the first quarter.

Furthermore, we have to add a contraction in operating margins as a direct consequence of massive investments in AI infrastructure.

In the case of Temenos it responds to customer captivity: banks may delay the transition to the new pricing scheme or purchases of the newest software version under harsh economic conditions, but they eventually will. I find hard to think about something riskier for a bank than switching its core application.

For ASML it also stems from the demand side, but customer captivity materialises in a much stronger way than that of Temenos: there's so little offer of their product range that it can absorb almost any aggregated demand with its backlog order.

There were also top performers in the portfolio. I feel enthusiastic about their prospects for the coming years. If we are on the edge of (or already in) a recession, I am ready for it!

INTRINSIC VALUE GROWTH

	Cumulative	Annualised	Period
Name			2022
S&P500 ex-financials	10.39%	10.39%	10.39%
Adobe	9.86%	9.86%	9.86%
ASML	0.51%	0.51%	0.51%
Auto Partner	15.90%	15.90%	15.90%
Autodesk	29.98%	29.98%	29.98%
Dotdigital	11.17%	11.17%	11.17%
Evolution Gaming	45.05%	45.05%	45.05%
Games Workshop	7.19%	7.19%	7.19%
Kelly Partners Group	28.95%	28.95%	28.95%
LVMH	24.10%	24.10%	24.10%
Mader Group	44.47%	44.47%	44.47%
Meta Platforms	(34.20%)	(34.20%)	(34.20%)
O'Reilly Automotive	5.43%	5.43%	5.43%
Temenos	(25.26%)	(25.26%)	(25.26%)
ZIGExN	16.99%	16.99%	16.99%
Aggregated	9.12%	9.12%	9.12%

Quality at a reasonable price.

Quality is often described as a financial measure of the abstract realm, an obscure side of business interactions where subjectivity prevails, but quality also leaves its traces in the physical world, dominated by accounting principles.

One of the most important lessons that I have learned in the last two years is that looking for cheap investment opportunities or high-quality enterprises alone is a recipe of failure.

A good investor should, in my view, focus on quality **and**, at the very least, be sensible to the price being paid.

This now lies at the heart of my investment approach.

I generally look for low indebtedness, wide margins, growing enterprises with honest individuals at the helm, generating high returns on capital and with the ability to reinvest excess earnings at those rates for **long periods of time**.

Durability is to compounding as water is to life.

FINANCIAL QUALITY: METRICS

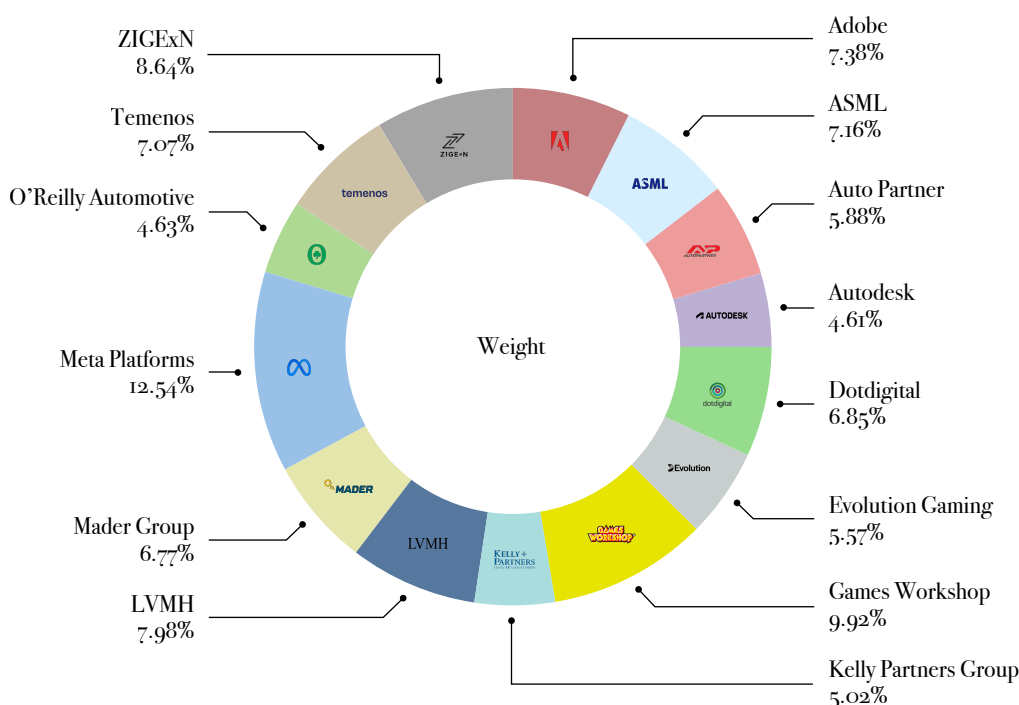
Metric	Portfolio	SPXN
	2022	2022
ROCE	33.34%	25.07%
FCF-ROCE	22.42%	18.68%
Revenue growth*	17.90%	12.16%
EPS growth*	19.85%	26.80%
FCFPS growth*	22.71%	14.58%
Gross margin	67.77%	47.82%
EBIT margin	27.26%	22.80%
FCF margin	23.64%	18.65%
Cash conversion	109.26%	113.55%
Interest coverage	x108.67	x44.08
FCF yield	4.68%	4.16%
PER	x21.82	x21.17

*4-year CAGR.

Companies in portfolio.

In 2022, some of the companies in portfolio saw their earnings reduced or stagnated. In some cases, this reduction was significant (as in the case of Meta Platforms). I must also add that most of them did increase their intrinsic value, either organically or via acquisitions.

The year closed with 14 high-quality businesses of diverse sizes and sectors:



Having said that, I believe the benefits of Adobe's competitive position outweigh the cons.

Owner's earnings increased 9.86%, with a market return of -40.37%.

Adobe detracted -1.37% the overall returns of the portfolio last year.

Adobe.

Another great year for Adobe was eclipsed by the announcement of the acquisition of Figma which, if confirmed, will become the most expensive M&A for the company in its more than 40 years of history (both absolutely and in relative terms).

I felt disappointed with management after this announcement was made. Paying +20 times sales is egregiously expensive, especially under the current market conditions.

ASML.

Since joining the company as a full-time engineer in 2019 it stroke me the strength of its culture and values, which I consider to be one of the ultimate competitive advantages of a business in any sector.

The leading Dutch manufacturer of photolithography machines experienced a substantial drawdown in its market price (circa 30.0%) in 2022, which is partly due to its initial rich valuation (roughly x53 times earnings).

At year end its multiple has come down to a more reasonable (although still high) x34 earnings.

ASML continues to be the only EUV photolithography manufacturer in the world. Even in a cyclical sector like semiconductors, companies that enjoy big spreads between offer and demand of their products tend to fare well, independently of temporary reductions in the amount of new orders.

This responds to the fact that competitive advantages which stem from the demand side (customer captivity) tend to be more solid than those born in the offer side (e.g. lower costs).

Owner's earnings increased 0.51%, while its market quotation returned -31.49%.

ASML contributed +0.23% to the overall result last year.

Mader Group.

The latest acquisition is Mader Group, a somewhat obscure Australian provider of maintenance services for heavy mobile equipment in the resources industry.

This small capitalisation enterprise has grown EPS at a 25.0% CAGR since it was founded by Luke Mader back in 2005.

At the beginning of the year, the group started its operations in Canada as part of its international expansion plans. The first year in this new market points to replicate the behaviour experienced by what I consider to be the "hidden gem" of the company: its US segment.

The company had another outstanding year, delivering an owner's earnings increase of 44.47%. The market translated this into a performance of +46.37%, leaving its quotation at a PER of x25.98 at year end.

Mader contributed +0.50% to market performance for the full year.

Meta Platforms.

After the announcement from Apple of their new privacy policy for iOS users (also known as ATT) in the early months of the year and the subsequent market drop -almost 27 percentage points in a single session-, I got interested in the company.

The more I read about how Facebook and Instagram generate revenues, the more appealed I became about the core FoA business. So I decided to open a position around US\$200.0/share.

I was probably premature, but my believes remain strong that the company has the power to make up for ATT's impact and return to a double digit EPS growth in the coming years.

The market seems to disapprove the increase in capital expenditures, often linking them uniquely to the new segment named Reality Labs (cited in numerous news and articles). This is just not true. Most of these expenses relate to AI R&D and data centres, which aim to provide a higher add targeting value using less personal information. This is, effectively, improving Meta's core advertising business.

These expenditures are also self imposed. Mark has decided to invest heavily in AI. In combination with the fact that he has almost his entire net worth in Meta Platforms stock, my view is that these expenses can be cut anytime if the outcome is not satisfactory.

Owner's earnings decreased by 34.20% due to flat revenues with higher operating expenses. Its market performance reflects an excessive degree of negativity -in my view-, with a decrease of -64.45% for the year and leaving its quotation at 4.76% FCF yield (PER of x13.28 before net cash and equivalents) at year end.

Meta Platforms was the second main detractor to market performance, contributing -3.43% to the full year.

Temenos.

The Swiss provider of core-banking software solutions announced at the end of 2021 that it would offer its clients the possibility to switch from a term license (one-time payment) to a subscription-based pricing scheme.

Some months after initiating the position, Temenos reported poor results for the third quarter of the year. After assessing them, I came to the conclusion that banks were not cancelling contracts but delaying the transition to subscription ones given the uncertainties in the macro environment.

This reinforces the main idea that led me to invest in the first place: the transition to a subscription pricing model increases predictability and recurrence of sales, which improves the quality of revenues.

After this announcement, the price bottomed around CHF50.0/share (down from CHF70.0/share).

I studied the transition towards subscription-based schemes in other software companies like Microsoft or Autodesk (the latter being more comparable to what Temenos is going through as it is also a vertical software business), and the market reacted in a similar fashion in both cases: short-term focus drove the price down before initiating a climb in the stock quotation for many years after subscription sales began to catch up.

It is said that history does not repeat itself but it often rhymes. I believe Temenos will prove to be a similar investment in the next years.

Owner's earnings decreased by 25.26% (in line with expectations with the shift towards the new subscription-based pricing model). The market translated this into a performance of -59.97%, leaving its quotation at 7.86% FCF yield (or a PER of x19.32 before net cash and equivalents) at year end.

Temenos was the main detractor to the overall market performance last year, contributing -4.52%.



The Japanese search aggregator continued with the good momentum shown in the last months of 2021 after the pandemic and its related restrictions started to ease.

In the last four quarters, the company has generated JPY21.3/share in EPS. I believe ZIGExN will soon return to its pre-pandemic growth and profitability levels, specially being run by who I consider to be an honest person and a great capital allocator: Joe Hirao.

Owner's earnings increased 16.99%. The market translated this into a performance of +19.05%, leaving its quotation at 9.09% FCF yield (or a PER of x15.37 before net cash and equivalents) at year end.

Nonetheless, the abrupt fall in purchasing power of the Japanese yen during 2022 (one euro was equal to JPY146.0 at year-end, compared to JPY130.0 in the early months -a decrease of -10.4% in yen's value!-) erased all capital and dividend gains from last year.

ZIGExN contributed +0.81% to market performance for the full year.

Mistakes ‘della giornata’.

Waystream.  waystream

During the first months of the year I studied this Swedish micro cap, a manufacturer of FTTx switches for industrial and public networks that employs 21 people (yes, twenty one) with high returns on capital and which seemed to be trading at a big discount to its intrinsic value.

It is run by its founder, Fredrik Lundberg, who owns a big portion of the shares outstanding.

The investment thesis was relatively solid: often, these extremely small companies heavily rely on face-to-face meetings and technology conferences to gain new customers. The pandemic had stagnated Waystream's growth due to the absence of this type of events and the company was starting to return to an attractive level of backlog orders and sales growth after restrictions started to ease in the second half of 2021.

Furthermore, the fibre communications sector is growing fast in developed countries as the need for higher speed data transmission materialises.

After following the company for a couple of months more and confirming the return to the path of growth, I decided to open a small position at SEK20.0/share with a c.3.0% weight in portfolio. Waystream then reported strong first semester results and the stock reacted, raising to SEK33.0/share in less than one month (that's a staggering 65.0%!).

As a new investor, sometimes I lack confidence in my own assessment of small and micro companies, and there were some sensitive points in my thesis which got me slightly concerned about the future of the business:

- Absence of recurring revenue. Waystream manufactures and markets its products but these do not require much maintenance and, when needed, Waystream does not offer these services.
- There was not much information about Fredrik Lundberg (CEO and founder) that I could find on the internet.

Soon after initiating the position, Fredrik was interviewed in a Swedish local TV channel. This may sound silly but the truth is that I did not get the best impression, so I decided to follow my gut and sell the stock in the subsequent days. Sometimes a picture (in this case a video) has a deeper impact than a thousand paragraphs!

There is no guarantee yet that this was a mistake, but the market has continued to close the gap and the

company now trades at around SEK70.0/share (a +350.0% run from the original purchase price).

Readings.

Reading is one of the most effective ways of fostering personal development that I know of (specially when it is combined with a self reflection on the matter).

Below is the list of texts whose reading was most enjoyable last year:

- Atomic habits (James Clear).
- Competition demystified (Bruce Greenwald).
- Investing for growth (Terry Smith).
- One up on Wall Street (Peter Lynch).
- Outsiders (William Thorndike).
- Richer, wiser, happier (William Green).
- The education of a value investor (William Green).
- The little book that builds wealth (Pat Dorsey).
- The obstacle is the way (Ryan Holiday).
- The psychology of money (Morgan Housel).
- The Warren Buffett's next door (Matthew Schiffrin).
- You can be a stock market genius (Joel Greenblatt).
- 100 baggers (Christopher Mayer).

Best wishes for 2023.