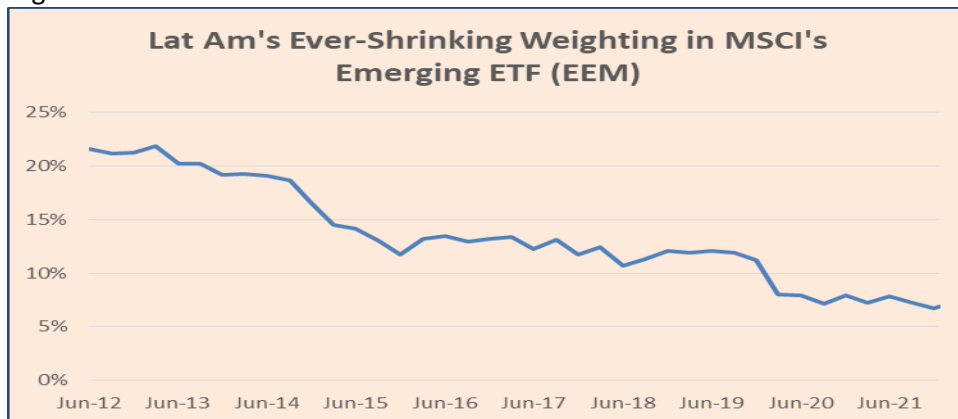


## Kyklos Capital

### Outlook: Loading Up in Lat Am

*"Take time to deliberate, but when the time for action has arrived, stop thinking and go in."*  
Napoleon Bonaparte

Latin American stock markets are well-known territory for many American investors. Before the Berlin Wall fell and Asia had its economic miracle, many US institutional portfolios sported large weightings in Mexican and Brazilian debt and equities. If it feels like we no longer hear all that much about that part of the world in financial circles, it might be because foreign investors have largely exited, as shown by Lat Am's decade-low weighting in the main index ETF (EEM, below). Kyklos, as a bottom-up active investor, has recently bought two attractive stocks from the region.



We added **Ferreycorp** to the portfolio in January. The company is the exclusive Caterpillar distributor for Peru and several smaller countries in Latin America, and about one half of their sales are to mining companies. Peru supplies about 12% of the world's copper, similar to Saudi Arabia's or Russia's share of oil. Copper prices are near all-time highs, and will continue to be supported by demand from electric vehicles, alternative power generation and other green technologies which require more copper, while new sources of supply are hampered by environmental and political concerns. Miners in Peru have proposed a whopping eight new copper projects which would create a boom for Ferreycorp's business, but in 2020 voters elected Pedro Castillo as President. Castillo is a hard-leftist who is hostile to business and, especially, to mining companies.

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Our Ferreycorp bet is naturally hedged however, with a business model built to withstand bad news. When orders for new Caterpillar machines dry up, customers rely on their old equipment, and need more services and spare parts. Few mining companies are willing to risk their operations by using competing parts suppliers, so Ferreycorp's operating margins for this activity are more than double their total margins, and allowed 2021 profit to stay positive despite a decline in overall sales. The company will survive until its next order boom.

Meanwhile, the most extreme political proposals by the current government are unlikely to be implemented. The Castillo government does not control Parliament, the courts, or the army. More likely is an early exit from power, which has happened to three presidents in Peru in the past five years, and would likely mean an administration less hostile to mining companies. Even after a sharp January rally which pushed Ferreycorp shares up over 30% (in dollars), we estimate the forward PE at about 6, with a dividend yield at 8%.

Our other recent Latin American bet is **Despegar.com**, which we bought in November, just before Omicron emerged (see our November letter). Despegar has leading online travel agent platforms in Mexico, Brazil, and Argentina, where the company is based. Our investment case for the company is based on its short-term survival prospects during Covid, and its exceptional long-term growth prospects when travel recovers. In Despegar's key markets, credit-card usage is low, and customers rely on the company to arrange travel financing through local banks. It has successfully extended its payables terms with airlines and hotel companies to conserve its working capital during the Covid period. During the crisis, it has acquired leading online brands in Mexico, Colombia, Chile, and Brazil, at valuations far below pre-Covid levels. Improved branding has meant higher prices — the "take rate" — which will lead to sustainably higher operating margins after recovery, and the expansion into the big Mexican and Brazilian markets are a long-term game-changer for potential profits. Post-Covid, we expect their sales to exceed historic peaks, at higher operating margins. On our bullish scenario, we see a potential multiplication of the share price, which is currently under one half of the 2017 IPO. We are willing to wait out Covid for that potential.

Charlie Gushee  
January 31, 2022

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