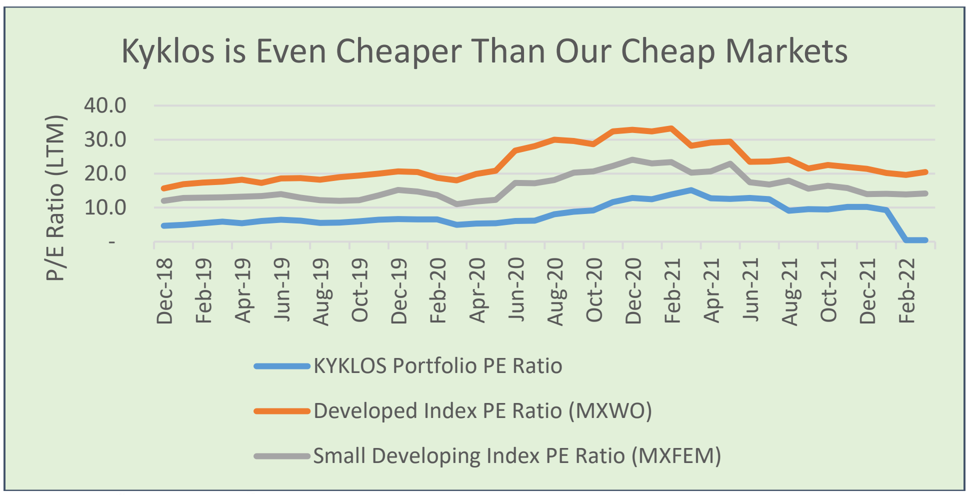
Kyklos Capital

Outlook: Why We're Not Just Chasing Low PE Ratios

"Just because something is cheap does not mean it is not going to go down." Warren Buffett

Kyklos is an active fund manager, and equity valuation is a critical part of our process. We create models of future earnings for every company in which we consider investing, which we use to compare with valuations of comparable companies in other emerging markets and with the company's historical valuations. We also define the future catalysts that would drive the share price higher, and set it to a rough timeline. Our markets are rich hunting grounds for cheap stocks, thanks to the "frontier discount" (below), and we look for companies with strong strategies to narrow the discount on their shares. But with greater uncertainty to future company earnings everywhere, we are more focused than ever on specific drivers and triggers, and less on the market's willingness to re-rate our names to higher valuations.



The list of risks to company earnings everywhere gets longer every day. It includes: the rocketing cost of raw materials and transportation, upward pressure on wages, increasing company borrowing costs as governments' easy money policies end, continuing Covid disruptions to supply chains and consumer demand, protectionist trade policies, wars, and coups. To compensate, we look for bigger upside potential in our stocks, potentially over a longer time frame. Roughly one-half of our positions are likely to create value for us because of

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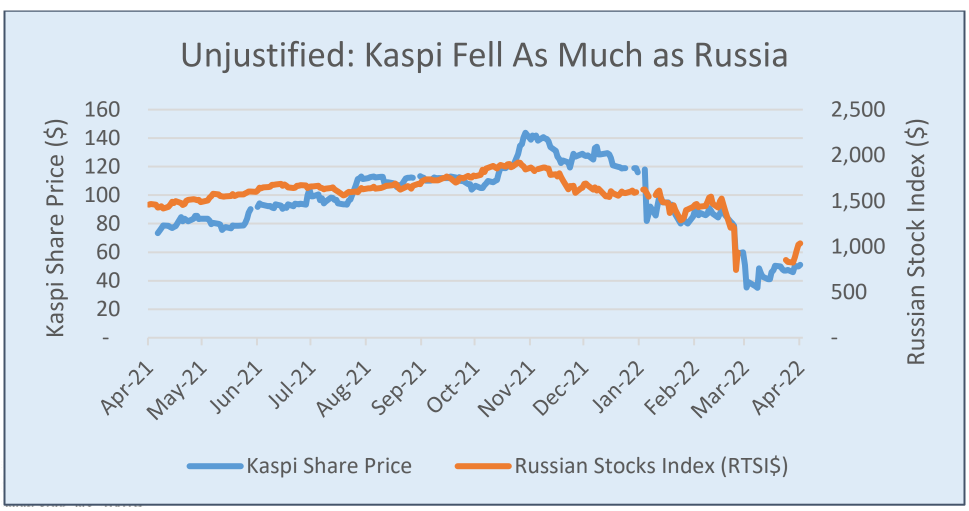
disruptive business models or strategic expansion plans, and they are less sensitive to short-term GDP or consumption trends. Our estimated share price upside in our portfolio now averages over +100%, and our expected holding timeline runs as long as three years.

During March, we doubled our position in Kaspi, Kazakhstan's leading fintech player and largest listed company. In the year following our initial investment after Kaspi's initial public offering in 2020, Kaspi's share price nearly tripled. Since then, its loan book and revenue have about doubled, earnings per share have grown by 161%, and owners' equity has increased by over 50%, powered by huge growth in users of its online platforms for payments, loans, e-commerce, and other services. That rally has been followed by a meltdown in 2022, with January's riots in Kazakhstan, the sidelining of its longtime strongman, Russian support for the current regime, and February's invasion of Ukraine. Stocks in surrounding countries including Kazakhstan fell about as much as Russian stocks in sharp panic selling (below), and Kaspi's share price fell nearly back to its original IPO price. Kazakhstan is not subject to Western sanctions and is not at war, however. It has a fully functioning economy and currency, and oil products that account for two-thirds of the country's exports now sell at some 50% higher prices than in 2021, cushioning much of the economic impact from the crisis. Our bet is that Kaspi, as an a-political and essential player in the country's economic development whose products solve many problems for its restless consumers, will thrive again in the near future. On our forward estimates, the stock carries a PE ratio below 8, more like a traditional bank than an aggressively growing disruptor. We think investors will return to the shares as the company demonstrates its growth resilience, and have bet accordingly.



Charlie Gushee
March 31, 2022

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