FSSA Investment Managers

September 2021

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Monthly Manager Views

FSSA Regional India Strategy

As the saying goes, "There are two kinds of forecasters: those who don't know, and those who don't know they don't know." Recently, we have seen hordes of the latter kind, garbed as analysts, Unicorn founders, freshly-minted CEOs and so-called "experts", as they engage in modern-day snake oil salesmanship, which is what seems to pass for Fundamental Equity Research these days. The difference between making forecasts and predictions is the difference between a rational investor and a soothsayer. Today, there are a number of companies and analysts who desperately pretend that a different set of rules apply to them. To that end, they have even invented a new jargon-littered language that has been enthusiastically adopted by the investing community. Some of the words and phrases being used (and over-used) these days make us wince. Let's look at a few.

"TAM" or Total Addressable Market: When I started my career as an analyst 20 years ago, certain things were key to forecast what might become of a business over the long term (i.e. five to ten years). These included an understanding of the market size of a product or service and its growth potential; assessing why certain businesses in that industry were doing better or worse than others; and evaluating the management quality and figuring out the alignment (both financial and cultural). Today, it feels like all that analysis is now captured in one word, "TAM", which companies are helpfully providing to analysts and they, in turn, end up using it as a fig leaf to justify almost anything – from the current small scale of the business, the pitiful margins, the ridiculous sales/marketing strategy and, of course, the outrageous valuation. It feels like the time when people used to mention enterprise value (EV)/click or EV/eyeballs or EV/square foot.

Unit Economics: We used to think that, for young businesses, one needs to see if it is able to generate a positive contribution margin to cover some of its fixed costs and then calculate how long it would take to achieve breakeven. But in the "free money" era, the term has become

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convoluted, as analysts are rewarding businesses who don't want to do any of that. Customer Acquisition Cost is the new buzzword and Unit Economics have been reduced to some sort of weird distortion aimed at justifying massive upfront costs. We used to look at how much a company is spending on sales and marketing, analyse the mix of short-term promotions and long-term advertising (good old above and below the line costs – where is the line now we wonder?), how the sales team was organised, their incentive structures and what a business was doing to prevent mis-selling. Nowadays, that seems like a primitive way of trying to understand basic unit economics; what the phrase now means is anyone's guess!

Value Proposition: "What is your value proposition?" analysts are asking companies these days. But, isn't that something that the analyst needs to figure out? By all means, ask the management for their views, but regurgitating those same views without critical reasoning is pointless, in our view. What is it that makes a company generate superior returns on capital employed (ROCE) and what makes its growth and returns sustainable? It could be many things – a brand, technology, license, etc. But what we have been hearing (and what is often not said) is that the only value proposition many of these new businesses have is access to unlimited, unabashed funding.

Flywheel: A surprising number of management teams we meet these days are hard at work pushing "Flywheels" as they attempt to defy the gravity of flawed business models. The term was made popular by Amazon as a way to describe the virtuous cycle that happens when the whole business model is aligned to offer a remarkable customer experience. But it seems the term is now being used instead to provide a remarkable initial public offering (IPO) roadshow experience, which the analysts are lapping up.

Pivot: We have heard this word more in the last 12 months than ever before. Companies now are desperate to tell analysts their pivots in life; and they are pivoting quite often to the next fancy thing, which salivating analysts are gobbling up as it helps them to see the almighty "Path to Profitability".

Path to Profitability: Another recent favourite. By brewing a concoction of TAM, Value Proposition and Unit Economics, with some Flywheels and Pivots along the way, the modern soothsayers are able to discern a "Path to Profitability". The whole sham is not unlike TV evangelists prescribing a path to heaven that they have divined. I am sure the CEOs of some of these companies would secretly love to find this path to the Promised Land that seems so obvious to some investors.

As more and more people are pivoting away from common sense, our team is resolved NOT to pivot away from our (admittedly) boring way of investing. We have been through these manias before and now, more than ever, we must be vigilant. Our goal is to keep it simple – preserve our clients' capital and grow it steadily by investing in good businesses, run by good people, for the long term.

* Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 30 September 2021 or otherwise noted.