Investing in Times of Crisis: The Case of Greece

October 2023

Tico Capital

About Tico Capital

Tico Capital Management is an investment partnership focused primarily on global equities with a long term, contrarian, opportunistic, private equity approach to public markets. The strategy has specific emphasis on idiosyncratic, misunderstood, and underfollowed small and mid-cap securities.

We are long term investors - a private equity approach to public markets with a multiyear investment horizon allows more flexibility to take advantage of market volatility and is a significant competitive advantage over peers focused on shorter term results.

We work collaboratively with the management teams of the companies we invest in to achieve world class returns.

Tico Capital Management is headquartered in London, UK.

Investment Philosophy

- **Most importantly, we seek asymmetric return profiles** – equity investments are underwritten with a conservative base case showing 100% + upside and a bear case indicating limited downside. Positive optionality is considered but not included in our initial return profile estimates. We only invest in companies **trading at material discounts to their intrinsic value**

- These asymmetric return profiles are found by focusing primarily on **idiosyncratic, misunderstood, underfollowed, unloved securities**. The Fund has a contrarian bias. We seek to avoid the herd and benefit from a longer-term investment horizon

- **We are long term investors**. A private equity approach to public markets with a multi-year investment horizon allows more flexibility to take advantage of market volatility, and is a **significant competitive advantage over peers focused on shorter term results**

- **A concentrated portfolio** (with 5-10 positions accounting for the majority of the invested capital) allows for superior performance. Capital markets are generally efficient and true bargains are rare, but **there are always areas of opportunity for patient, concentrated investors, particularly when considering smaller capitalization international equities**

- **Our generalist and benchmark agnostic investment approach allows us to be opportunistic**, to take advantage of market dislocations in specific industries or geographies, and to avoid relative value traps

- We **avoid investments where the thesis is heavily reliant on variables that are outside the company's control**, such as commodity prices and regulatory decisions, **unless we are confident that a highly negative scenario is already reflected in the share price**. This allows a greater degree of conviction in the bear case and base case valuations and reduced volatility in outcomes

- **Attractive valuations and rigorous analysis are the cornerstones of reduced fundamental risk**. Purchasing securities at steep discounts to their conservatively calculated intrinsic values (with an attractive "margin of safety") reduces the risk of permanent capital loss and improves the likelihood of superior returns

- **Business and management quality** are additional drivers of reduced fundamental risk and superior long-term returns

Sources of Opportunity

- **Orphan international small capitalization securities** where there is limited or zero sell-side coverage

- **Companies undergoing fundamental, multi-year transformation** to their business models, management teams, and end markets, causing market participants to materially misprice their shares. We believe most investors struggle to correctly analyze change due to cognitive and behavioral biases which often anchor their forecasts in past – and no longer entirely relevant – circumstances

- **Complex special/idiosyncratic situations** that most investors are unlikely to understand. These may include companies involved legal processes, regulatory scrutiny, hidden asset values, spin offs, and local products/markets which international investors may not properly assess

- **Good companies operating in challenging macro-economic and regulatory environments**. Some of our favorite and most successful investments have come from geopolitical crises and/or regulatory changes. At our core, we seek to be a provider of liquidity to forced sellers who (a) do not have the advantage of a long-term investment horizon and aligned capital, (b) overreact to negative news flow, and (c) generally lack the willingness to look through short-term volatility to superior long-term returns

- **M&A candidates**. Companies trading at material discounts to their replacement value and/or which have significant value to strategic buyers. We generally view smaller capitalization companies as particularly attractive as they always have a greater degree of M&A optionality from strategic and private equity buyers. This buyout optionality is a permanent advantage that we actively seek to maximize

- **Most of our investments will exhibit several of the above characteristics.** These sources of opportunity will always exist. There will always be sectors and geographies temporarily out of favor due to negatives news flow, and corporate change is constant – if not increasing

Crisis Investing: Fundamentals

Short Term Price Movements vs. Long Term Fundamentals

In the short run, reliably forecasting share prices is about as realistic as hieromancy, ornithomancy, osteomancy, alectryomancy, ceromancy, or my personal favorite, tyromancy. For those who are not familiar with all the -mancy words (I certainly was not), here are some definitions:

- Hieromancy: divination through animal sacrifice, performed ritually and regularly in ancient Greece and Rome
- Ornithomancy: divination from the flight pattern of birds
- Osteomancy: divination from throwing bones
- Alectryomancy: divination in which a series of birds, or a single bird, select grains placed on letters
- Ceromancy (also known as carromancy): divination through analysis of wax
- Tyromancy: divination through the analysis of cheese. I remain unclear on the specific kind of cheese

However, we do believe that investing based on sound fundamental analysis does give a far more predictive view of long-term share prices.

Headline Risk vs. Fundamental Risk

As long-term value investors, we focus less on the share price of a security in 3 to 6 months and more on the underlying fundamental value of the business and the cash flows it will generate in the next 5 to 10 years.

Share prices often reflect short-term concerns and headline risks that are not representative of underlying fundamentals. These share price movements are a source of short-term outperformance and underperformance, as well as an opportunity to sell or short an overvalued security or to add at more attractive valuations. These short-term price movements usually overcorrect for recent news and investor sentiment. For patient investors, tremendous headline risk can lead to sizable short-term corrections and attractive buying opportunities.

Furthermore, we do not consider share price volatility as an inherent risk – rather, we view permanent capital loss or capital impairment as the real fundamental risks. The usual factors for either can include, but are not limited to:

- **Overly leveraged balance sheets – leading to dilutive equity issuances**
- **Disintermediated or low-quality business models with low sustainability of future cash flows as a result**
- **Fraud and other severe corporate governance issues**
- **Overpaying and thus establishing a cost base for an investment well above its realistically realizable value**

Paradoxically, headline risk often decreases fundamental risk by reducing prices further below their fundamental value and reducing the likelihood of overpaying, increasing the investment's margin of safety.

Time Arbitrage – A Rare Competitive Advantage

In a highly competitive industry, one of the only differentiations is arguably the ability to time arbitrage. Investing with a long-term investment horizon in volatile markets/stocks suffering from acute headline risk – but reduced or healthy fundamental risk – is a potent way of achieving superior long-term returns.

Time arbitrage essentially refers to trading short term share price risk – investing in an out-of-favor market, sector, and/or stock – for outsized long-term returns.

Most funds and investment professionals are extremely focused on managing short term returns, even if they claim they are not. This is completely understandable given the industry disproportionately values and monitors short-term returns:

- Most investment professionals work at firms where poor short-term performance can lead to a very swift firing
- Most fund managers have investors who are focused on short-term returns
- Short-term underperformance is easily quantifiable and noticed – taking the right measures to deliver long-term performance and underperforming in the short term is not readily visible/noticeable except to highly sophisticated investment professionals, and even then involves a great deal of subjectivity

TLDR: most people think short term.

Share prices will fluctuate for many reasons. These gyrations often have little to do with underlying economic value or operating fundamentals. The economic prospects of a firm rarely change as quickly as its share price. Time arbitrage – taking short-term volatility in exchange for superior long-term returns – is a core premise of thoughtful, analysis-driven crisis investing

How to Think Long Term

Maintaining a long-term perspective and investment horizon in the context of rapidly changing prices [and possibly paper losses] is easier said than done. It is most easily accomplished when the right structural and psychological conditions are set:

Structural – Process Oriented

- Investors with a similar investment horizon and matching investment philosophy
- Lock up periods and similar share class mechanisms
- Investment professional compensation tied to long-term returns and heavily tilted away from short-term results

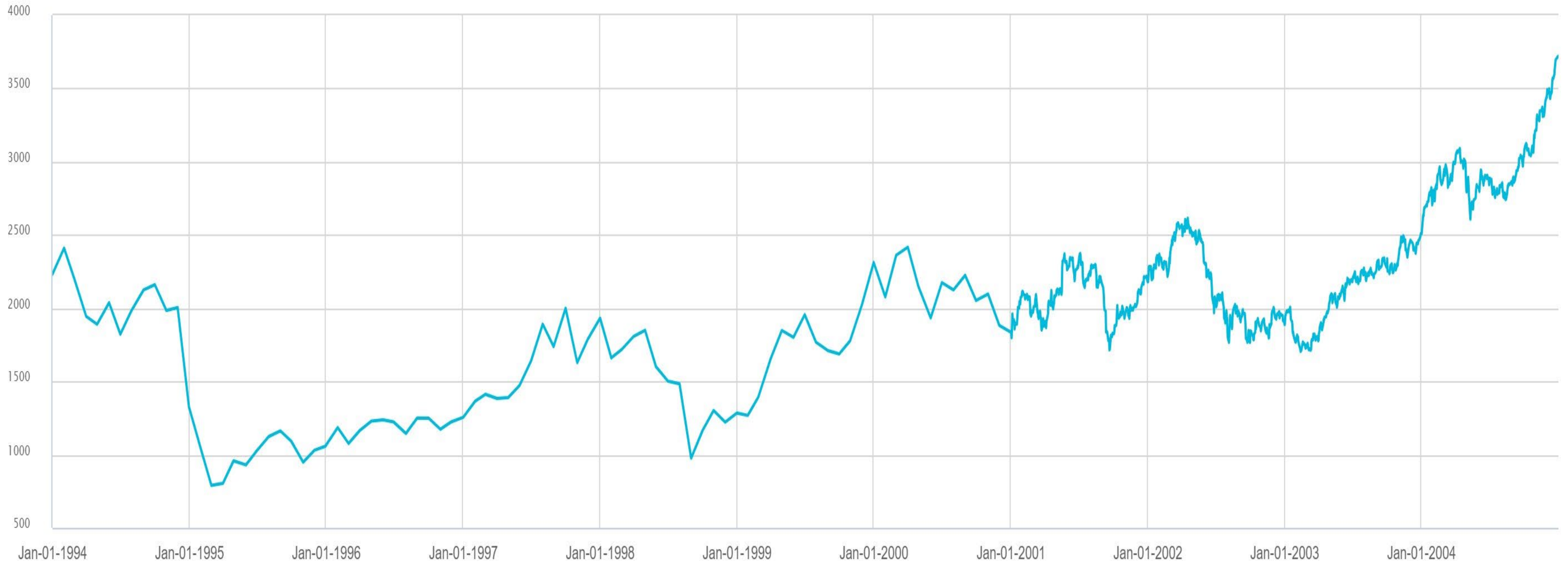
Structural – Investment Criteria Oriented

- Extreme selectivity toward companies displaying: (1) strong balance sheets, (2) business models with significant competitive advantages, (3) defense business model with the ability to withstand economic volatility → all of which helps have significant confidence in projections of cash flow and the company's ability to survive through the crisis. Avoid situations where there is risk of permanent capital loss or capital impairment
- Avoiding the investments with the most potential upside but a greater degree of volatility in outcomes (for instance, bankruptcy risk) ultimately makes for a more sustainable process
- Avoid portfolio leverage – don't seek liquidity in times of crisis, provide it

Psychological

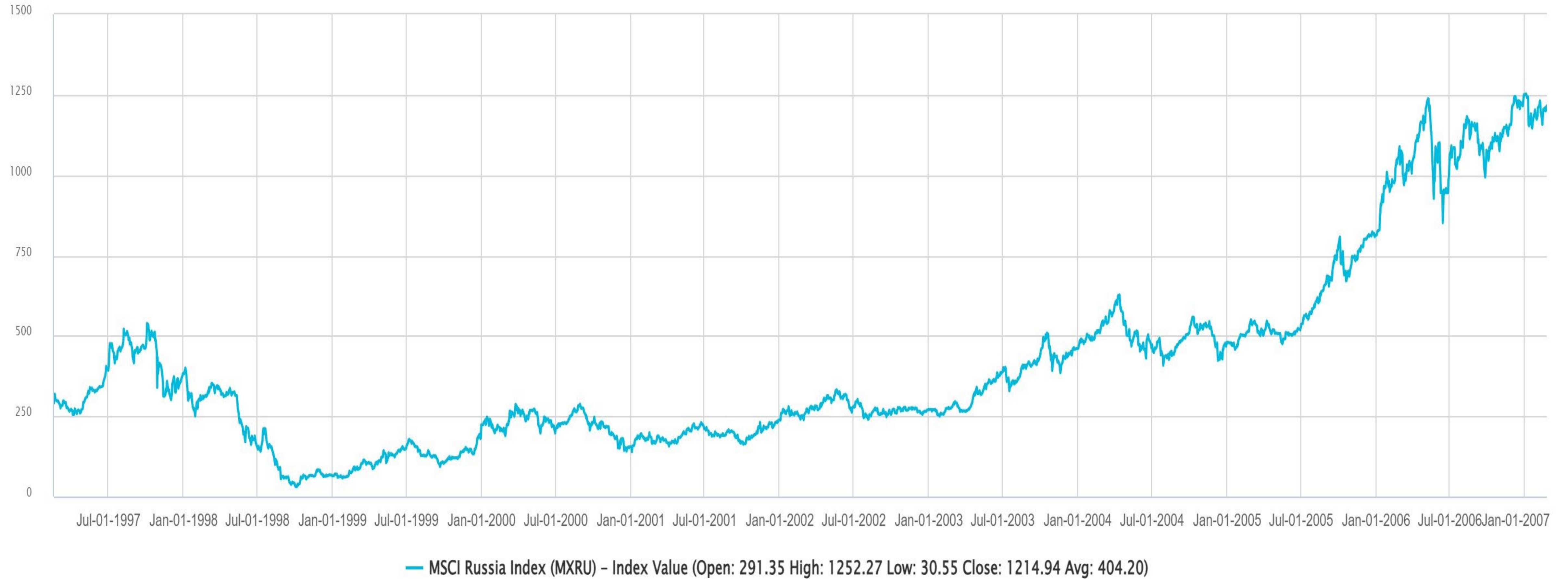
- Make sure you are able to withstand significant ST losses and to add at more attractive levels
- Make sure you have sufficiently researched to understand all important variables → getting surprised is detrimental to psychological fortitude
- Set guidelines in advance on how to react to various eventualities → process is key, pre-commit to a set of actions depending on how events and valuations unforld
- Sticking to process makes you less likely to be impacted by behavioral bias
- Build discipline + patience
- Underwrite with purposefully/overly conservative assumptions trying to capture worst case scenarios
- DO THE WORK → don't blindly run into the burning building

Time Arbitrage + Significant Market Pessimism = Opportunity
The Mexican Debt Crisis

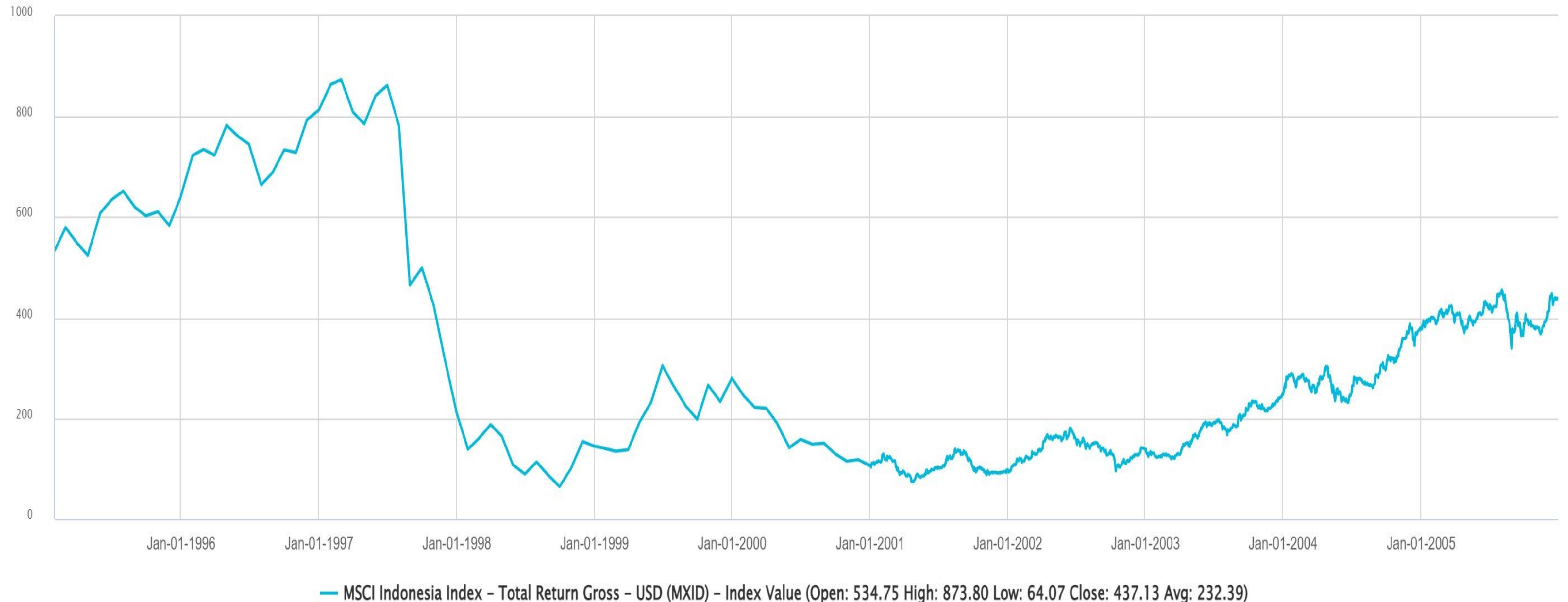


Mexico, Continued

Time Arbitrage + Significant Market Pessimism = Opportunity
The Russian Debt Crisis



Time Arbitrage + Significant Market Pessimism = Opportunity
The Asian Debt Crisis



Indonesia, Continued

Crisis Investing: Grexit

Headline Risk & Popular Opinion

Consensus view in 2011 through summer 2012: Greece is un-investable, Grexit is highly likely.

Some of my favorite predictions – Citi were reliably bearish the entire time:

EUROPE ECONOMY

Likelihood of Grexit Still 50-75%: Citi

Antonia Matthews

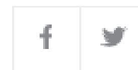
Published 10:43 AM ET Mon, 18 June 2012 | Updated 5:04 PM ET Mon, 18 June 2012

BANKS OCTOBER 12, 2012 / 6:25 PM / UPDATED 11 YEARS AGO

Citi lowers probability of "Grexit" to 60 percent from 90 percent

By Reuters Staff

3 MIN READ



6 February 2012 | 32 pages

Global Economics View

Rising Risks of Greek Euro Area Exit

- We raise our estimate of the likelihood of Greek EA exit ('Grexit') to 50% over the next 18 months, from 25-30% previously. This is mostly because we consider the willingness of EA creditors to continue providing further support to Greece despite Greek non-compliance with programme conditionality to have fallen substantially.

Citigroup warns 90% chance of Grexit

Katie Holiday

26 July 2012 •

Investment bank Citigroup has forecast a 90% chance Greece will leave the euro in the next 12 to 18 months.

How Likely was Grexit, Actually?

Highly debatable. But I'm pretty sure it was **never** 90%.

Some factors against Grexit:

- High Greek MP ownership of Euro-denominated assets → personally vested in continuation of Euro economy (who wants to lose 50%+ of their net worth overnight due to currency devaluation?)
- Lack of EU contingency planning around an orderly Eurozone exit
- Political capital invested in the European project
- **Significant** risk of widespread bank losses and fear-based contagion → fear of the unknown and devastating economic damage

Some factors for Grexit:

- The Germans
- Political exhaustion
- Domestic politics in Greece and other EU countries

The Grexit Investing Playbook

STEP 1: Target Selection:

- SEEK high quality companies with strong balance sheets
- AVOID banks (impossible to get comfortable on the range of outcomes and **significant** risk of permanent capital loss or capital impairment)
- AVOID companies that cannot withstand short to medium term turbulence

STEP 2: Select Suitable Candidates and commence significant research effort

- Narrowed the target universe to three companies
- Began a 6-month period of research which involved conversations with the management teams at all major Greek companies, as well as with government officials (including a slightly surreal call with Papandreou) and European Troika representatives to better understand the macroeconomic and political developments
- Established a contrarian view that Grexit was unlikely, and more importantly, that a very high likelihood was priced in

STEP 3: Finalize Investment Candidates and Investment Assumptions

- Underwrite with significantly draconian assumptions → even if things get horrendously bad, we make money
- Investments in Jumbo (a leading non-food discount retailer) and Hellenic Exchanges (the near-monopoly cash equity and derivatives markets operator)
- Deep fundamental research into both companies to get comfortable with their prospects

Importantly, compared to traditional EM debt crises where local FX depreciation affects USD returns, the EUR is a far stabler currency → mitigating currency risk substantially.

Illustrative Crisis Underwriting: Hellenic Exchanges (EXAE GA)

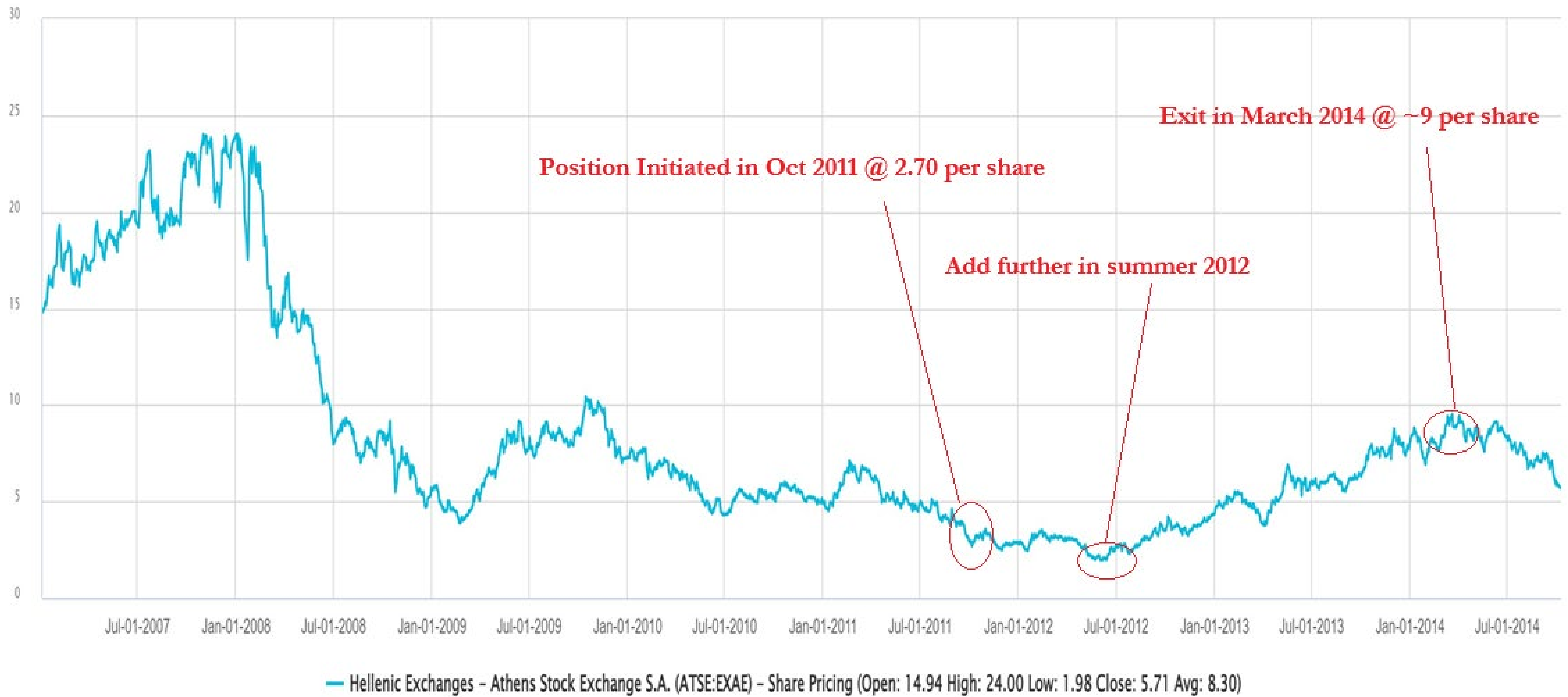
- **Company Description:** Hellenic Exchanges operates a near-monopoly of the Greek cash and derivatives markets. Dark pools have not penetrated the Greek market given low liquidity, regulatory risk, and inadequate market opportunity relative to incurred costs

- **High Barriers to Entry:** It would be nearly impossible for a new entrant to set up in Greece given the important network effects, set up costs, and regulatory barriers

- **Source of Opportunity – Significant Short-Term Volatility, Excellent Business in a Terrible Macro-Economic Environment:** The company's shares were mispriced in H2 2011 due to temporary factors – mainly the risk of Grexit, though this was arguably fully priced into the valuation at investment initiation (versus a relatively limited fundamental risk of actual Grexit). We spent months prior to investment initiation speaking to government officials, European Troika representatives, and the CEOs and CFOs of the main Greek banks and industrial firms. This analysis gave us confidence that Grexit was highly unlikely. We then waited for an entry point that all but priced in the worst possible operational and macroeconomic outcomes

- **Valuation & Asymmetric Return Profile:** At initial purchase in October 2011, shares offered upside of ~ 100% in a Base Case with purposefully conservative assumptions including normalized EBITDA margins of ~50% (versus a 5-year average of 68.5%), and average FCF generation of ~ EUR 15 million (versus a 5-year average of over EUR 50 million), with a normalized 16% FCF yield on these draconian forecasts. This analysis included the particularly conservative assumption that the Greek banks, a source of significant trading value, would be nationalized and delisted (rather than the more likely and ultimate outcome of recapitalization by private investors – incidentally, a source of significant one-time revenue – and continued listing). Downside was further limited by the company's strong balance sheet, with an unrestricted net cash position of ~ EUR 75 million (versus a market cap of ~ EUR 175 million), and the company's ability to redistribute this unrestricted cash to shareholders in the form of special dividends (which it did in following years). Finally, FCF remained robust. The company continued producing FCF of over EUR 10 million per year in 2011 and 2012 during peak Grexit uncertainty, before then seeing FCF increase to over EUR 55 million in 2013

Hellenic Exchanges Share Price



Greece Today

From Pariah to Poster Child

EUROPE | THE ECONOMY

Greece's Economy Is on the Mend. What the U.S. Can Learn From Its Revival.

By Jack Denton

May 26, 2023, 10:54 am EDT

With Grexit Averted, Guess Whose Debt Outperforms?

Greece's economic recovery is ratified in its low cost of borrowing, which is below the average for investment-grade borrowers anywhere in the world.

March 23, 2023 at 5:00 AM GMT

By Matthew A. Winkler
Matthew A. Winkler, editor in chief emeritus of Bloomberg News, writes about markets.

Analysis

Greek PM's election win driven by recovery from economic crisis

Jon Henley
Europe correspondent

The electorate have credited Kyriakos Mitsotakis and his conservative party with building back from disaster

The New York Times

Greece, Battered a Decade Ago, Is Booming

It is one of Europe's fastest-growing economies, and while investors and tourists are flocking to the country, memories of austerity measures are still fresh for Greeks.

Pandemic Crisis Investing: Jumbo (ATSE: BELA)

Investment Summary (from August 2021 Memo)

Jumbo is Greece's leading retailer of toys, baby products, and stationery. The company has successfully expanded into non-core areas, which now represent almost 2/3 of sales, turning Jumbo into a best-in-class big box discount retailer. Despite the difficult macroeconomic and political environment, Jumbo has sustained strong growth and market share gains at the expense of weaker competitors and boasts a fortress balance sheet (net cash of ~ EUR 500 million). Key Investment Highlights:

Leading Market Share & Brand Recognition: In Greece, Cyprus, and Bulgaria Jumbo enjoys ~40% market shares in its core segments and ~20% market shares in its non-core segments. It is a well-known and trusted brand and on track to achieve similar market shares in Romania.

International Growth & Local Market Expertise: Jumbo has very successfully expanded in Romania and Bulgaria, increasing shareholder value with limited incremental invested capital. We believe the company could move into additional markets in the next 5-10 years and see significant runway in Romania.

Limited Threat from Online: The average product price is under EUR 5 and Jumbo focuses on bringing customers into stores using toys as a traffic driver to then cross-sell with highly optimized store layouts. Jumbo is a destination discount retailer and a valued anchor tenant to commercial outlet center operators.

Best-in-Class & Aligned Management: Tolis Vakakis (born in 1954, CEO until 2013 when he assumed the role of Chairman) has been a driving force in Jumbo's success and owns ~ 20% of the outstanding shares. He has developed a talented team of senior management, further institutionalizing the firm.

Cost Advantages: Jumbo achieves far superior margins relative to its competition, driven by economies of scale, excellent procurement + logistics, and owned real estate. These cost advantages are passed to consumers, driving a virtuous cycle of market share gains and increased scale: essentially scale economies shared.

Undeniably Defensive: Jumbo flourished during the Grexit Crisis and remained highly profitable throughout the pandemic despite store closures. *Comparative performance illustrates the defensiveness: Greek GDP declined from EUR 241 billion in 2008 to EUR 187 billion in 2019, but over the same period Jumbo's Greek sales increased from EUR 366 million to EUR 518 million, while broader group sales more than doubled from EUR 404 million to EUR 848 million*.

At position initiation (EUR 13.1 per share), our models indicate fair value of ~ EUR 30 per share (with conservative assumptions and attributing zero value to expansion beyond Jumbo's existing markets), which compares favorably to the current share levels. We anticipate an over 15% FCF yield to market cap and over 22% FCF yield to EV in 2026 (and FCF yields of 8.4% to market cap and 12.5% to EV in 2021).

Investment Risks / Pre-Mortem (from August 2021 Memo)

Supply Chain Disruption: This is currently the key risk, which has partially weighed on the share price and broader sentiment. 70% of Jumbo's products are sourced from Asia (mainly China), with less than 10% sourced domestically. 80% of goods are sourced in USD, so the gross margin is sensitive to USD/EUR fluctuations. Chinese-US relations are worsening, and the pandemic has led to serious supply chain disruption with Chinese ports often closed due to a single COVID-19 case. Shipping (~20% of COGS, or 9.7% of sales) is getting more expensive, with baseline rates increasing up to 5x (more on the following slides).

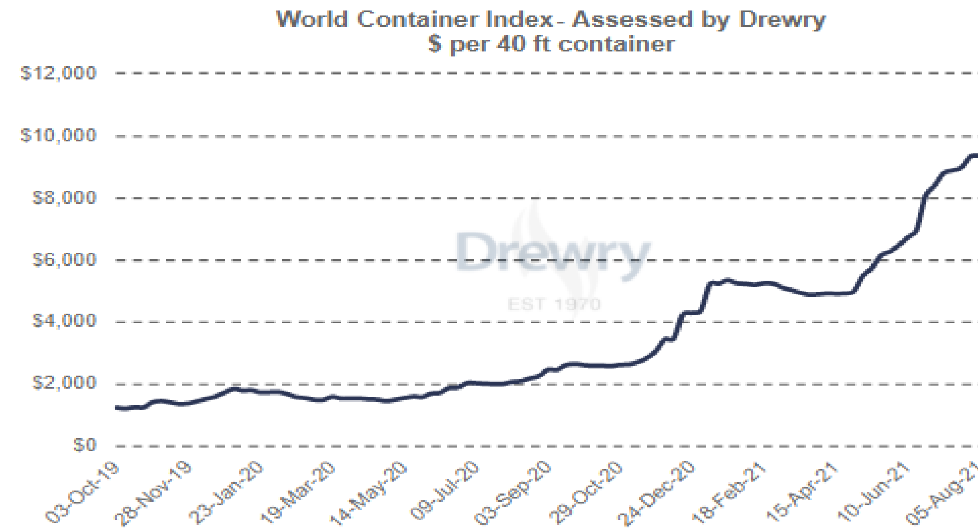
Macroeconomic Disruption: Further lockdowns, a worsening of the pandemic, the ensuing economic crisis, and regional political instability (including Grexit 2.0) are all risks. We believe however that Jumbo's discounted price points, defensive business model, and track record of growth through the worst of the GFC and Grexit crisis all point favorably to the business' resilience. On FX: results are increasingly sensitive to RON as the Romanian operation grows in importance, while EUR depreciation against the USD would increase COGS given 80% of products are sourced in USD (so far in 2021 the EUR has appreciated 3% against the USD, a small benefit to Jumbo's H2 2021 and FY 2022 gross margins).

Worsening Competition or New Entrants: Jumbo is the clear leader in its core segments, and a strong contender in seasonal and home products. As we will show, the business benefits from robust profitability, very competitive pricing, and a fortress balance sheet. Jumbo clearly outclasses its existing competition. We would note Detsky Mir – which boasts 26% market share (67% among specialized retailers) in children's goods in Russia as a potential longer-term competitor (more information on Detsky Mir in the Appendix), but as of now they have no plans to expand beyond Russia, Belarus and Kazakhstan and their strategy hinges on smaller stores and a greater emphasis on online sales. Online disintermediation is a longer-term concern but is offset by Jumbo's price points and products (and their increasing online presence). Discount retailers continue to prosper globally despite Amazon and its imitators, and Jumbo is no different. Pepco also contemplating market entry but more focused on apparel.

Challenging Demographics: Jumbo's markets are challenged by low birth rates and aging populations, which will affect demand for their core products in the longer term. Offset by diversification into non-core areas. We detail the demographics further in the Appendix.

Potential Tax Rate Increases: Jumbo operates in markets with low corporate tax rates (ranging from 10% in Bulgaria to 22% in Greece).

Shipping Rates (from August 2021 Memo)



Shipping rates have hit record highs due to demand factors (global inventory re-stocking, a faster-than-anticipated recovery in consumption) and supply issues (namely port congestion at multi-year highs – particularly in Asia – which effectively takes capacity out of the market). According to Clarkson, port congestion in East Asia ran at roughly 2 million TEU from 2016 to 2020. This increased briefly to 3.2 million TEU at the height of the pandemic in March 2020 and remains around 2.5 million TEU today. Note that port congestion is compounded by inland disruption with limited excess warehouse capacity in some geographies (mainly in North America), railroad congestion, and shortages of truck drivers. Drewry estimates that the combined effect of port and inland congestion will lead to a capacity loss of 16% in 2021 following a loss of 11% in 2020. Note that European ports are generally more efficient, boasting a higher degree of automation and inland waterways, reducing rail and driver linked pressures. Low idle container rates (4% after spiking early in the crisis) adds further stress.

While regulators and other actors have attempted to cap freight rates, these measures are mostly unsuccessful as (1) container lines operate in international waters outside single country jurisdiction, (2) liners could theoretically avoid specific ports attempting to cap rates, and (3) alliance members co-manage capacity. Any outside regulation of rates would have to be exceptionally well-coordinated to succeed and is not something we would count on.

We view this as a short-term phenomenon which will normalize in the coming 24 months. The congestion issues are not insurmountable, and in the medium term we are comforted by an improving orderbook for large container ships as liners invest windfall profits into additional capacity.

Jumbo Investment Summary ~2 Years Later

We conservatively underwrote a significant decline in gross margins linked to heightened shipping costs and other inflationary pressures, thus anticipating a decline in the gross profit margin from 51.8% in 2020 to 42.8% in 2022. Our expectation was that this was needlessly conservative, but even with these assumptions and a gradual margin normalization through 2026, fair value was north of EUR 30 per share. When modeling we prefer to air on the side of caution, but we were fully aware that Jumbo had numerous levers to pull, namely:

- Improved container utilization by cutting larger products and increasing the volume of higher value smaller items
- Ceasing supply to wholesale and franchisors
- Sourcing from Europe-adjacent markets – Vakakis has been particularly active in Turkey
- Culling less profitable inventory
- Price increases made possible by lower average prices, mix, and competitor weakness

By executing on all fronts, as we expected, Jumbo was able to not only maintain gross margins, but increase them to 55.7% in 2021 (and we expect a broadly similar level in 2022). Our expectation of outperformance was further cemented by channel checks and conversations with market actors in late 2021 and early 2022. We believe these gains will be maintained over time.

The Results

Jumbo – Looking Forward

To put the growth potential in context, it is worth noting that in 2014, Greece and Cyprus, the company's traditional core markets, accounted for 91% of total sales with less than EUR 50 million of sales coming from Romania and Bulgaria. By 2021, Jumbo generated turnover of EUR 263 million from Romania and Bulgaria, representing an increase of over 5x in 7 years. The runway is particularly significant in Romania, a country of 19 million (versus Greece at under 11 million) still early in its urbanization (54% urban in 2020 versus 80% in Greece). Despite this greater rural bias, Romania already has far more catchment areas than Greece because of its greater population, as we show below – along some other regional comparatives..

Catchment Area Analysis	Cities with > 1MN	Cities with 500K to 1MN	Cities with 250K to 500K	Cities with 100K to 250K	Cities with 30K to 100K
Greece	0	1	1	6	54
Cyprus	0	0	0	2	3
Bulgaria	1	0	2	4	27
Romania	1	0	12	17	40
Hungary	1	0	0	12	48
Croatia	0	1	0	2	13
Ukraine	5	4	15	21	13

Jumbo – Looking Forward II

Jumbo's Greek estate services an average of ~ 200,000 people per store. Assuming a similar ratio in Romania, the company's store count has the potential to increase 6x to 96 locations over time. Furthermore, assuming ratios of 250,000 to 400,000 people per store for adjacent markets gives the company a longer-term runway of an additional 161 stores in Hungary, Croatia and Ukraine (when/if the country becomes investable again for the right franchise partner).

Catchment Area Analysis	2020 Population	% Urban	GDP / Capita	Stores	Population per Store
Greece	10,715,549	79.7%	USD 19,151	53	202,180
Cyprus	1,207,361	66.8%	USD 26,623	5	241,472
Bulgaria	6,927,288	75.7%	USD 9,976	9	769,699
Romania	19,286,123	54.2%	USD 12,896	16	1,205,383
Hungary	9,749,763	71.9%	USD 15,899	39	250,000
Croatia	4,047,200	57.6%	USD 13,828	12	350,000
Ukraine	44,134,693	69.5%	USD 3,727	110	400,000