

HOROS

ASSET
MANAGE-
MENT

QUARTERLY LETTER
TO OUR CO-INVESTORS

APRIL 2020

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Dear co-investor,

We finished what has been one of the most challenging quarters we have ever experienced, both professionally and, of course, personally. Therefore, I would like to start by thanking you for your great trust in our work and wishing you all the best in these tough times.

I would also like, if I may, to express my congratulations and gratitude to the rest of the members of the Horos team, for the great effort they are making, so that our service and work can continue to be carried out as normally as possible. You can count on our dedication and rigor to be the same as always.

This quarter has been characterised by a sharp market downturn, as a result of investors' panic and increased demand for liquidity, in the face of economic uncertainty due to the coronavirus pandemic. Thus, Horos Value Iberia fell by -35.1% compared to -27.6% of its benchmark index. On the other hand, Horos Value Internacional was down by -30.2% compared to -19.6% of its benchmark index.

In this quarterly letter, I would like to try to do my part to explain the severity of the market crash. But, most importantly, in an exercise in transparency that goes beyond previous letters, I will devote the bulk of this letter to discussing, in great detail, the changes we have made to our portfolios in order to mitigate potential risks and increase their upside potential to all-time highs.¹

We are convinced that we have an outstanding investment opportunity ahead of us. We are also proud to be able to say that in March, one of the worst months for the stock market on record, we had net inflows from our co-investors.

Yours sincerely,

—|

Javier Ruiz, CFA
Chief Investment Officer
Horos Asset Management

¹ For more detailed information of the track record and upside potential of the funds, we invite you to look at the annexes included in this document, as well as the information contained on our website.

Executive summary

We should not, like sheep, follow the herd of creatures in front of us, making our way where others go, not where we ought to go.

— Seneca

The severe and sharp market downturn this quarter is a result, on the one hand, of the impact that the coronavirus pandemic and the consequent government actions are having on economies around the world. On the other hand, as markets operate as complex adaptive systems, the uncertainty about the scale and duration of this impact triggers a disproportionate —non-linear— reaction from investors, who liquidate their assets all at once and cause a panic-selling feedback loop.

We at Horos have tried to adapt and take advantage of the situation by exiting or reducing our exposure to the few portfolio companies with a higher liquidity risk to weather the current environment (**offshore drillers** and the stainless steel company **Outokumpu**), as well as to those investments with relatively lower upside (such as **IWG, LSL Property Services, Alphabet** or **Alantra Partners**), in order to increase our exposure to overly punished sectors or companies. Specifically, we have significantly increased our investment in the shipping and infrastructure sector for liquefied natural gas and crude oil (**Teekay Corp., Teekay LNG** and **Golar LNG**), as well as in businesses with the capacity to deal with this crisis, such as **Catalana Occidente, Sonae, AerCap** and **Naspers**.

Additionally, this quarter we benefited from the positive performance of uranium (**Uranium Participation Corp.** and **Yellow Cake**), caused by the forced shutdown of major mines due to the coronavirus outbreak. Likewise, our long-standing investment in **Clear Media** was taken over at the end of March, delivering a capital gain of 80% since our entry in the second half of 2019.

The importance of mental models

A mental model is simply a representation of how something works.

— Shane Parrish

Charlie Munger, Warren Buffett's longtime business partner, is possibly one of the most complete investors in history and therefore a model to consider when improving our analytical and decision-making skills. In particular, Munger has always been known for using a multidisciplinary approach to deal with any problem he faces, including the investment process. To this end, he has relied on the basics of the most important academic disciplines. This aspect is very relevant, given that if we focus all our efforts on mastering a single discipline, **our mind will try to torture reality to fit our limited knowledge set.**

To a man with only a hammer, every problem tends to look pretty much like a nail.²

But which disciplines are the most essential? Although knowledge is unlimited and any help is welcome, it is true that some of them can be more useful to us when analysing companies, the industries in which they operate or the functioning of economies and markets. Specifically, we at Horos rely, without being exhaustive, on **economics** (for example, the Austrian Business Cycle Theory and the Liquidity Theory as theoretical frameworks for understanding the formation of cycles), **behavioral psychology** (biases and heuristics and their impact on investor behaviour), **philosophy** (stoicism and its relationship with value investing), **mathematics** (the concept of convexity and its Talebian application to improve the risk-return ratio of our portfolios), **statistics** (the Kelly Criterion to concentrate, given equal upside, on those investments in which we have the greatest conviction) or **biological evolution** (complex adaptive systems as a model for understanding how markets work).

We have discussed some of these mental models in the past and how we apply them. For example, the concept of convexity led us to invest in uranium through the vehicles that buy and store it, instead of purchasing shares of the major producers of this commodity (read [here](#)). You have also heard us talk about the importance of behavioral psychology in improving our investment process (see [here](#)). Today, I would like to focus on complex adaptive systems, as they help explain some of the recent market action.

² Quote from Kaufman, Peter D. (2013): *Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger*, Expanded 3rd Edition. Macerline, Missouri: PCA Publication, L.L.C.

What do biological evolution and markets have to do with each other?

Evolution and economics are actually two different examples of a larger phenomenon called complex adaptive systems.

— Michael Shermer

In his recommended book *The Mind of the Market*³, the writer and scientific historian Michael Shermer shows the undoubted similarities between how biological evolution and economies work, as both are complex adaptive systems that **arise from simple interactions between their elements**—whether species or economic agents—in seeking to ensure their survival and that of their offspring. In fact, Shermer proposes to merge both disciplines under the name of Evolutionary Economics.

The dynamics of a complex adaptive system can be understood by looking at the behavior of drivers in traffic situations.⁴ Let us imagine an urban road where many vehicles regularly move. Let us also imagine that one day there is an accident and the authorities force drivers to move more slowly than usual when they reach the area. Little by little, a queue of vehicles is formed as they slow down and those that lag behind, without even knowing the reason, find that the road is heavily congested. A small interaction—a lower speed zone—has triggered a traffic jam.

Let us further elaborate on the problem. Now, a second group of drivers who usually use that route learn about the traffic jam by radio or by any mobile app and decide to use, as one would expect, the typical alternative route. As everyone starts to use this second route, another predictable bottleneck is created. Finally, this is where things start to get complicated. A third group of drivers gets on the road, faced with the choice of whether to take the first or the second route. What decision will they take? Will they think it may make sense to take the first because, with the existing information, the other drivers will choose the second? Or, maybe they will go further and come to the conclusion that if everyone thinks the same, it will be better to choose the second option as the rest will opt for the first one? Or, maybe, after much thought, they will come to the conclusion that it is better to stay at home and telework?

³ Shermer, Michael (2008): *The Mind of the Market: How Biology and Psychology Shape Our Economic Lives*. New York: Holt Paperbacks.

⁴ Example taken and adapted from "An Introduction to Complex Adaptive Systems" (Farnam Street Blog).

The more layers or groups we add to the problem, the more complex the final result becomes to predict. Such a simple example, as the one mentioned above, only scratches the surface of the richness of a complex adaptive system. How can we pretend to predict the behaviour of the economy or markets, where these potential interactions and decisions of each player are multiplied? Obviously, we cannot —I leave it to the reader to reflect on the implications of this. However, understanding how they work and some of the attributes of complex adaptive systems can help us to interpret certain situations that occur in stock markets.

Michael Mauboussin, the multidisciplinary analyst we have talked about several times in the past, has conducted several studies in which he analyses stock markets as complex adaptive systems. In particular, Mauboussin stresses that we can understand these systems if we think of them as being made up of three layers.⁵ The first layer is made up of **heterogeneous agents** (drivers in our previous example). What does it mean that they are heterogeneous? Basically that each agent has different decision rules, which evolve according to changes in the environment and their attempts to anticipate these changes (each driver tries to decide what to do according to the information he has and how he expects the rest of the drivers to react to the traffic situation). The next layer is made up of the interaction of the agents, which forms a structure or **emergence** (the road traffic). Finally, this emergence acts as a **higher-level system**, whose behaviour cannot be predicted by analysing the individual decisions of each of the agents (we cannot predict how traffic will eventually turn out by studying individual driver behaviour). In short, complex adaptive systems, as stressed a moment ago, are not predictable.

However, understanding some attributes of these complex adaptive systems is interesting given their application to the stock market. Specifically, we are going to focus on three of them: the heterogeneity of the agents that the system is comprised of, feedback loops and nonlinearity.⁶

Let us start with the first one, **heterogeneity**. Why is it so important for a complex adaptive system to be comprised of heterogeneous agents? Very simple: for the system to work properly. **Otherwise, the system will become fragile and inefficient.** Think of the stock market. In the long term —we at Horos work under this premise, at least— companies' market value tends to reflect their underlying value. However, the time it takes for this to materialise depends on countless factors, one of which is the heterogeneous behaviour of investors. Why? Basically, if many

⁵ Mauboussin, Michael (2009): *Think Twice: Harnessing the Power of Counterintuition*. Boston: Harvard Business Press.

⁶ I recommend the following paper to dig deeper into the topic, written by Michael Mauboussin: "Revisiting Market Efficiency: The Stock Market as a Complex Adaptive System" (Journal of Applied Corporate Finance. Volume 14, Number 4. Winter 2002).

investors act in a similar way, this can generate inefficiencies in the prices at which stocks trade at. These inefficiencies may be more relevant the more investors act the same and the longer they maintain this **herd behaviour**.

An example of this can be found in historic stock market bubbles, such as the 'Nifty Fifty' (50 companies perceived as the most solid at the time) in the 70s or the 'dotcom' in the late 90s. In these cases, the narrative that certain stocks can only rise becomes ingrained in the investor community and more and more money flows into these companies —exiting from others— feeding the rise of their shares —and the fall of the rest— and the conviction about their inevitable rise. The process **feeds back** on itself (the second attribute of complex adaptive systems) until it is no longer viable to do so and triggers its terrible burst. The same thing happens in bear markets when investors panic and, for a while, selling seems to be the smartest decision because tomorrow the stock market will be lower. An example of this would be the last months of 2008 and especially the first two months of 2009. Until, finally, companies' valuation acts as a gravitational force and stock prices start a violent recovery phase.

However, we do not need to go that far. In the last two years we have witnessed two periods in which the heterogeneity of investors has been conspicuous by its absence. Thus, from the beginning of 2018 to the beginning of 2020, we experienced what we previously called "the great divergence."⁷ It was a period characterised, in particular, by the concentration of capital flows into companies with greater earnings certainty and higher market capitalisation (more liquid), regardless of the demanding multiples at which they traded. The other side of the coin was suffered by companies with more cyclical businesses and smaller market capitalisation (less liquid), experiencing a steady decline in their share price, also ignoring the attractive multiples at which they traded. This situation is therefore reminiscent —with its peculiarities— of the aforementioned bubbles with their powerful feedback loops.

Now, however, we find ourselves in an environment that is much more reminiscent of that experienced in 2008. Uncertainty about the impact and duration of the coronavirus pandemic and the policies adopted in different countries have led investors into a wave of selling, regardless of the valuations that companies will offer once the world recovers from this shock. **When panic selling takes hold in the market and preference for liquidity shoots up, the heterogeneity of investors becomes absent and a feedback loop ensues, triggering absurd price declines and extreme volatility.**

⁷ To learn more about this topic, we encourage you to view our First Annual Conference for investors (see [here](#)).

These extreme outcomes can be explained by the third key attribute of complex adaptive systems: **non-linearity**.

Being complex adaptive systems, they are nonlinear and constantly changing as circumstances and conditions and information warrant, and those changes can be abrupt, violent, and frightening.⁸

In short, the uncertainty and incomplete information of the present situation, in the face of the potential and very different scenarios that the coronavirus pandemic may trigger, causes investors to react in unison, first extrapolating the worst of the worlds in a very short time and then trying to anticipate the upward turn of the market. This has led to many records being broken in terms of the speed of the stock market downturn or in terms of daily price changes in many indices. **As the real impact of this terrible situation becomes clearer, volatility will decrease, and the market will more accurately discount its consequences.**

This is as far as market behaviour is concerned. Now, what do we expect to happen in the global economy and what do investors fear? The following section will be devoted to this.

A difficult to digest triple shock

Most people in the market are looking for earnings and conventional measures. It's liquidity that moves markets.

— Stanley Druckenmiller

We have just seen how uncertainty and incomplete information drive investors' herd behaviour, triggering violent market swings. But what kind of uncertainty are we talking about? What scenarios are stock markets around the world pricing in — or starting to price in? In essence, the market is anticipating a potential liquidity shock from two other shocks caused by the coronavirus pandemic.⁹

The first of these shocks, the **supply shock**, began several weeks ago and has become more pronounced over time as the virus has spread from China to the rest of the world. The vast majority of companies have stopped or drastically reduced

⁸ Quote from "How Markets as Complex Adaptive Systems Process COVID-19" (Bill Miller, March 16, 2020).

⁹ This article by Juan Ramón Rallo is highly recommended: "Políticas de estímulo: impotentes frente al coronavirus" (El Confidencial, March 13, 2020).

their activity, either because borders have been closed or because their employees cannot leave their homes to go to work. As a result, economies have seen their productive capacity plummet. Additionally, this supply shock has triggered the **demand shock**. Citizens around the world, faced with the prospect of losing their jobs or seeing their salaries cut, substantially increase their demand for liquidity. The same is true for companies, which have to face a series of costs (employees' salaries, payments to suppliers, etc.) with their capacity to generate income greatly reduced. **All this leads to a reduction in present consumption and investment and to building up cash**, with the aim of increasing the cushion against potential future requirements. This is another explanation for the sharp market downturn in recent weeks. Many investors prefer to own cash today—even if it is worth much less—than to live with the uncertainty of what its value may be in two months' time, particularly if that money is needed.

I would like to take this opportunity to remind you why we always recommend that our investors only invest the money they will not need for several years. This is the only way to ensure that we do not have to sell at the worst possible time, that is, when the value of our investment is at a depressed level, which is precisely when its upside potential is at its highest.

The third shock is a consequence of the two previous ones: the **liquidity shock**. If the situation worsens and becomes more protracted, there will come a time when the liquidity needs of households and businesses to meet their payments become unsustainable, ostensibly increasing their financing needs, e.g. by asking the supplier for a delay in getting paid, requesting the bank for a line of credit or tapping the capital markets to issue debt. The problem is that, in this environment of economic paralysis, no one has the capacity to get funding. Capital markets effectively shut down or become more difficult for many firms to access as the required return on new debt issuance rise. Furthermore, banks lose their ability—and willingness—to lend as their current and potentially future delinquency rate increases. For this reason, central banks around the world have launched huge monetary stimulus plans, which seek to reduce or mitigate this liquidity shock.¹⁰ In the same vein, every government in the world has adopted economic policy measures to help combat this problem. Time will tell whether these decisions that central banks and governments are taking are on the right track and what their likely undesirable consequences are.

¹⁰ To learn more about the U.S. Federal Reserve's monetary stimulus plan and its risks and side effects, I recommend reading the following article by Juan Ramón Rallo: "La masiva socialización de riesgos de la Reserva Federal" (El Confidencial, March 25, 2020).

Now that we have tried to succinctly assess the economic impact of the pandemic so that we can understand investors' fears, we will devote the rest of the document to explaining what we are doing with our portfolios and what we can expect from them in the future.

Nothing new under the sun?

Companies that have no debt can't go bankrupt.

— Peter Lynch

In an environment such as the one we have just described, it is practically impossible for our investments not to be affected to a greater or lesser extent. How can we proceed as investors in this challenging situation? Basically, in two ways. On the one hand, we have to assess the **liquidity risks** of our companies at a time when access to funding becomes as tight as it is now. Illiquidity can turn into insolvency and lead, as desperate measures on the part of the companies' management teams, to capital raises that are highly dilutive for their shareholders or to the sale of assets at knock-down prices. In this sense, we are reasonably confident about these potential financial risks, as today **around half of our companies have a net cash position**. In addition, with the exception of a few situations described below, the remaining companies meet at least one of the following requirements: very low debt, strong cash generation capacity, defensive business, predictable cash flows or owned assets that cover debt and/or liquidity needs.

On the other hand, we must analyse whether the **normalised cash generation capacity** of our companies has been impaired or whether the business, once we have overcome this crisis, will maintain its previous dynamics intact. Both factors, liquidity risk and normalised cash generation capacity, have contributed to increasing or decreasing our conviction in our investments and their upside potential. As a result, they have determined the changes we have made in our portfolios this quarter.

HOROS VALUE INTERNACIONAL

Stake decreases & exits:

OFFSHORE DRILLERS

We trimmed exposure from 3.7% to 0.8%

Holdings: Shelf Drilling (0.7%) and Borr Drilling (0.1%)

A very clear case in which liquidity risks have increased greatly in recent weeks is that of the companies that own **offshore oil rigs**. In particular, we see financial risks that are difficult to assume in those companies that do not have good contract coverage (leased rigs), with greater exposure to deepwater oil drilling (whose rigs are contracted much further down the cycle, as they require a longer duration and greater amount of capital committed by the oil exploration and production companies) and with a tough debt schedule (near term and high maturities). It is worth noting that as we explained in our previous letter, we already decided last quarter to reduce our exposure to **Valaris** for these same risks, especially as our thesis of the recovery in their rig utilisation rates was delayed more than expected and their liquidity profile worsened. For this reason, we drastically reduced our weight in the company and upped our investment in **Shelf Drilling**, where liquidity risks are much more limited, as it has greater contract coverage and less exposure to the deepwater segment than **Valaris**.

At the end of February, even before the impact of the pandemic became acute and Saudi Arabia decided to end the oil production cuts in the absence of an agreement with Russia, we exited our investment in **Valaris** for the risks we have just discussed, following the release of the company's annual report and the comments made by the management team at the conference call. In addition, despite their significant declines, we decided not to add on our investments in **Shelf Drilling** or **Borr Drilling**—the two offshore drilling companies that remain in our portfolio—in view of the foreseeable impact that low oil prices will have on oil companies' capital expenditures. While it is true that these low prices and the current tightness in capital markets may be the tipping point for a slowdown or a decline in US shale oil production and, ultimately, an oil supply that falls short of demand—leading to higher oil prices and increased E&P capex— **we believe that it does not make sense to take certain risks at a time when investment opportunities abound.**

STAINLESS STEEL

We trimmed exposure from 6.9% to 5.2%

Holdings: Aperam (5.2%)

We have also made changes to our exposure to **stainless steel**, where we had a significant position through our investments in **Outokumpu** and **Aperam**. In this case, although the liquidity risks are much lower than those discussed in the case of offshore drillers, we decided to exit our investment in **Outokumpu** (where we had already trimmed more than 40% of our position in February following its large share price increase) and concentrate our exposure to this sector on **Aperam**. The former has always had a weaker financial profile, with debt exceeding 3x in terms of net debt/EBITDA.

In addition, it is the company with the worst competitive positioning among Europe's listed companies in the sector. Despite its attractive current upside, we prefer to hold only **Aperam** in the portfolio, as it has a similar upside potential but a much stronger financial position. This fact will allow the company to weather any economic scenario that may arise, as well as having a management team with an excellent capital allocation strategy.

OTHER

Exited holdings include IWG, Alphabet, Zeal Network and LSL Property Services, by 9% of the portfolio in aggregate

Furthermore, we have fully exited from our investments in **IWG**, **Alphabet**, **Zeal Network** and **LSL Property Services**. In the case of **IWG**, we sold our position in the leading business center rental company at the end of January —weeks before the current environment unfolded— due to its low upside potential at that time. The rest of the exits were made solely because they had significantly lower upside than the remaining holdings in the Horos Value Internacional portfolio. These are times to take advantage of the great opportunities that the market is giving us and if we want to create value for our investors, we do not have to be hesitant to concentrate the portfolio on those ideas that we think will yield better returns in the coming years.

This first quarter of 2020, despite significantly negative returns on the indices and our portfolios, has seen the sale of our classic holdings in the UK companies **LSL Property Services** and **IWG** during January and February. Both holdings were among the oldest in our portfolio (as was **Clear Media**, which we will discuss later).

Over the last year, **IWG** shares gained more than 130% driven by the changes promoted by its CEO and largest shareholder, Mark Dixon, in the management model of the co-working space provider company. Specifically, Dixon established a program to create shareholder value by divesting—and repricing with the transaction—some geographic areas and moving to a less capital-intensive company model supported by a higher volume of franchisees, thus helping to scale up the business more quickly. This is the second time in recent years that we have successfully invested in this company.

As for **LSL Property Services**, the appraisal and real estate agency company gained over 80% in the last 6 months, thanks to the increased visibility of Brexit and the potential merger agreement with the UK market leader, Countrywide, at a time when high debt could stifle the latter. The prudent management of many of the companies we have in our portfolio, as well as their financial strength, allows them to take advantage of this type of opportunity when major turbulence arises. For the moment, it seems that **LSL** has finally ruled out the merger.

Both cases illustrate the fact that sometimes the catalysts for our investments come at the most unexpected time. Hence **the importance of having a solid investment process, combined with a very long-term horizon.**

Stake increases & new stakes:

LNG AND CRUDE OIL INFRASTRUCTURE AND SHIPPING

We increased exposure from 3.5% to 10.9%

Holdings: Teekay Corp. (6.6%), Teekay LNG (2.2%) and Golar LNG (2.1%)

In our opinion, the market is not properly discerning the liquidity risks of some of the companies in the shipping and infrastructure sector for liquefied natural gas (LNG) and crude oil. We find the case of **Teekay Corporation** and its subsidiary **Teekay LNG** particularly striking. For this reason, we decided to increase our exposure to **Teekay Corp.** and initiated a new stake in **Teekay LNG**.

In the case of **Teekay LNG**, the company that owns LNG carriers, it has coverage of long-term contracts signed with customers with low counterparty risk, which is particularly critical in these times of economic paralysis, as there is fear that customers will request the suspension of agreed payments due to force majeure. This contract coverage guarantees stability in its cash flow generation for the coming years regardless of the degree of utilization of the asset by the customer and the price of LNG (take-or-pay contracts), which allows the company to reduce

debt and reward its shareholders in a very attractive way, both through steady dividend increases and opportunistic share buybacks.

As for **Teekay Corp.**, let us remember that the company owns c.34% of **Teekay LNG**. Additionally, it controls c.29% of **Teekay Tankers**, a crude oil shipping business, and owns three FPSOs (Floating Production, Storage and Offloading of oil and gas) units. Interestingly, in addition to the positive dynamics of **Teekay LNG** that we have just mentioned, **Teekay Corp.** is also benefitting from the positive impact for **Teekay Tankers** of the prevailing depressed oil prices, as the demand for transport and storage of this commodity—and consequently, the freight rates of this type of vessels— has soared. In fact, since the end of February, **Teekay Tankers** share price has risen by nearly 100% at the time of writing.

Finally, one of **Teekay Corp.**'s biggest weaknesses was the past cash burn of its FPSOs. However, the company has been addressing the issue recently and at the end of March announced a new contract for its FPSO Foinaven, which caused the most headaches for the company in terms of cash burn. This contract is for ten years and involves an advance payment of \$67 million, which is significantly higher than our estimates. As for the other two FPSOs, Hummingbird was granted a contract extension to 2023 in 2019 and Banff—the third FPSO— will end its contract and operations in 2020, when it will be scrapped.

All in all, **Teekay Corp.** is possibly in one of the best spots of the last few years in terms of business performance and financial risks. In spite of this, this year its share price fell by about 60% from peak—at the beginning of 2020—to trough. It has been a long time since we found such a clear discrepancy between the performance of a business' fundamentals and its share price. This explains the increase in our exposure to the company.

We also invested for the first time in **Golar LNG**, a liquefied natural gas (LNG) infrastructure and shipping company. We believe that its share price was excessively punished in recent months, even taking into account a negative liquidity scenario for the company. This is a complex company to analyse, to which we have dedicated several months of work. To sum up, **Golar LNG** has exposure, through its different business areas, to practically the entire LNG value chain. Specifically, the company owns FLNG (Floating Liquefied Natural Gas) facilities designed to convert gas from offshore fields into LNG. Additionally, it owns several LNG carriers, as well as FSRUs (Floating Storage and Regasification Units). The company also holds a 50% stake in Golar Power, a joint venture formed with Stonepeak Infrastructure Partners in 2016, which owns—among other assets— 50% of Sergipe (located in Brazil, the largest gas-fired power plant in South

America) and Nanook (a FSRU that will primarily serve Sergipe), as well as 50% of Bacarena, another Brazilian gas-fired power plant that will not be available until after 2025. Finally, **Golar LNG** holds a 32% stake in **Golar LNG Partners**.

It is therefore a company that gives us exposure to the positive long-term dynamics of natural gas through its different lines of business. However, various short-term financial risks—which we think are manageable—are punishing the **Golar LNG** stock price, whose current market cap do not give any value to Gimi (contract for the exploitation of an FLNG that is 70% owned by Golar LNG and which, signed with BP for 20 years, will come into operation in 2023) or the potential extensions of Hilli (FLNG operating with Perenco, which could expand its production capacity), among others. In addition, Golar LNG is directed by Tor Olav, a Norwegian businessman with whom we met in November last year. He has managed to generate extraordinary returns over the last 20 years in the very tough shipping industry. Tor Olav owns 5% of the company, which guarantees an alignment of interests with the rest of the shareholders.

OTHER

Stakes were increased in AerCap (5.1% current weight), Naspers (4.8%) and Tai Cheung Holdings (2.1%), by 4% in aggregate

Aside from the significantly increased exposure to the shipping and infrastructure sector for LNG and oil, we took advantage of the panic selling in the period to increase our stakes in **AerCap**, **Naspers** and **Tai Cheung Holdings**.

AerCap is the global leader in commercial aircraft leasing.¹¹ Its share price has plummeted since mid-February, with a maximum drawdown of nearly 80% of its stock market value. When a financial company is trading at 20% of its book value, it is obvious that the market is pricing in little short of its bankruptcy. If this is the case, what are the fears that have led investors to value **AerCap** at these levels? And even more relevant, why did we decide to increase our stake in it? To answer the first question, we need to briefly review how **AerCap**'s business works. The company buys planes manufactured primarily by **Airbus** and **Boeing**, and then leases them out to the airlines for several years (sometimes they buy planes from the airlines themselves and then lease them back to them). To finance these acquisitions, **AerCap** either borrows on the capital markets or obtains bank financing. Herein lies the first of the fears. The uncertainty about the magnitude of

¹¹ If you wish to dig deeper into our investment thesis in AerCap, you can view the following video (see [here](#)) or read the following quarterly letter (read [here](#)).

the potential business decline has made it very difficult to issue new debt, as the returns demanded by investors are not acceptable.

If you cannot issue debt, how will you be able to meet your next investment commitments (new aircraft purchases) and debt maturities? Under normal circumstances, **AerCap** would cover these commitments, in addition to issuing new debt, with the cash flows generated by the business itself (income from aircraft lease rents) and the sale of aircraft on the secondary market. Indeed, here lies the second fear of the market, can you continue to collect rents in an environment where your clients cannot make money? Almost all the airlines in the world are suffering through one of their worst crises in history. If people cannot travel and planes cannot fly, it is only a matter of time before many of them become decapitalised and go bankrupt. On the other hand, **AerCap** has been an active seller of planes —with large returns— on the secondary market, taking advantage of the high demand in recent years for this type of asset. In this uncertain environment, it seems unlikely that they will be able to keep up the pace of divestments, so this source of liquidity is also diminished. This does not seem to be a particularly attractive scenario for investing in the company.

However, there are several factors that make us somewhat optimistic about **AerCap's** future. To begin with, **AerCap** has always been a very conservatively managed company, which has led it to operate with a high liquidity cushion to deal with possible adverse situations. Specifically, at year-end **AerCap** had a liquidity ratio that would allow it to meet a year and a half of investment commitments and debt maturities. In addition, the bulk of **AerCap's** aircraft fleet —worth over \$28 billion— could be used as collateral for future debt, if necessary.

Regarding the situation of its clients, **AerCap** has announced, like the rest of the companies in the sector, that it will facilitate a delay in payments to its best customers. Direct acquisitions of aircraft from the airlines themselves cannot be ruled out (in fact, other companies such as **BOC Aviation** have already done so) in order to relieve them financially and get good returns from the deal. In addition, **AerCap's** large scale has allowed it to diversify its client base enormously —to around 200— and to be able to be demanding with the guarantees required from those with a poorer operational and/or financial position, e.g. deposits for potential non-payments or minimal maintenance of the aircraft. More specifically, the company has significant exposure to Asian players (40% of revenues, including Russia), mostly Chinese state-owned airlines, where the risk of massive bankruptcies seems insignificant and where, on top of that, the situation is starting to recover somewhat —in fact, there are customers there who are starting to pay back deferred rent to **AerCap**. However, another aspect that helps us feel relatively

confident about airlines is the expected massive government bailouts of the sector, as it is an industry closely linked to national interests.

Finally, it is worth noting that, in an environment of paralysis in economic activity, **Boeing** and **Airbus** will not be able to continue manufacturing aircraft at the expected rate, so **AerCap**'s investment commitments would be drastically reduced. To all this, we should add what is possibly the best management team in the industry, as well as a structural growth trend in air traffic to which we will undoubtedly return once this pandemic is overcome.

Likewise, we took advantage of the decline in **Naspers** share price to increase our stake in the company. The South African holding company that owns technology platforms suffered a sharp price correction during the period, even larger than **Tencent Holdings**, the company's main asset and the bulk of **Naspers'** valuation. We are convinced that **Tencent**'s business ecosystem (online video games, video platforms, payments or social networks) protects the company in this challenging environment and will even benefit from it.¹²

The increase in our stake in **Tai Cheung** is due to the fact that during the previous quarter we had not yet completed building up our position. This company is a luxury real-estate developer in Hong Kong and the United States and owns 35% of the Sheraton hotel in Hong Kong.

Other major investment themes and holdings:

URANIUM

8.8% of the portfolio

Holdings: Uranium Participation Corp. (5.0%) and Yellow Cake (3.8%)

The fund's top position is our investment in **uranium** through the **Uranium Participation Corporation (UPC)** and **Yellow Cake (YCA)** vehicles, which purchase uranium for storage in order to give their shareholders exposure to the price changes of this chemical element. This quarter uranium performed well, posting a 10% gain in the period, with a particularly positive performance in the last week of March when the price of the metal rose by 13%.

This price spike in the last few days of the quarter is a reaction to the impact that the coronavirus is having on uranium supply. Specifically, the Canadian company

¹² If you wish to dig deeper into our investment thesis in Naspers, you can view the following video (see [video](#)) or read the following quarterly letter (read [here](#)).

Cameco announced the temporary shutdown —of at least 4 weeks— of its Cigar Lake mine, the largest operating mine in the world currently, amounting to 13% of world uranium production in 2018. Shortly afterwards, Namibia announced similar measures for the entire country, causing temporary closures or reductions in activity in its mining operations, impacting Rössing Uranium (4% of production) and Husab (6%) mines. As the pandemic spreads, it seems inevitable that it will also end up hitting the production of Uzbekistan, Kazakhstan, Australia or Niger.

Why is the price of uranium rising in this environment of declining economic activity, as opposed to other commodities? Basically because, as production from nuclear power plants is virtually unchanged —they cannot be turned off and on overnight— they contribute to meet the base load or minimum demand of the electrical grid. Their customers therefore continue to consume uranium. Nevertheless, nuclear power plants can, for example, adjust their inventories and/or delay their fuel reloads for a period of time, so that expected demand would fall. What, then, explains this significant rise in the price of uranium? The supply and demand dynamics prior to this crisis which, with the current situation, have been exacerbated.

We will not go over the uranium investment thesis again.¹³ However, it is important to remember that electric utilities have not purchased uranium on the long-term market for years (through contracts signed to acquire uranium over several years). This situation should be close to a 180-degree turnaround, as uncovered uranium requirements for the nuclear power plants to continue operating begin to pick up —dramatically in countries such as the United States. In a market where supply is not sufficient to cover demand after years of significant production cutbacks, if additional supply constraints occur, a significant tightening of the market is expected to prompt utilities to return to the long-term market. This is all the more true when **Cameco** has to buy more than 20 million pounds on the spot market this year (about 30% of the volume traded in 2019) and **Kazatomprom**, the largest uranium producer in the world, has announced that it will no longer sell uranium on that market —it will only supply uranium to buyers who have signed long-term contracts with them.

Oddly enough, the stock price performance of our vehicles has not been positive in the period (**UPC** lost -4.4% in the quarter and **Yellow Cake** -6.5%), thus increasing the discount at which these vehicles trade with respect to their uranium inventories. In fact, just before the turning point that occurred with the announcement of the shutdown of Cigar Lake, **UPC** was trading at one of its highest historical discounts, at levels similar to those of the 2008 financial crisis or

¹³ For a quick overview of our investment thesis in uranium, you can view the following video (see [video](#)).

the Fukushima accident in Japan in 2011. Only the sudden panic selling of investors can explain this anomaly.

CLEAR MEDIA

4% of the portfolio (exited in April)

One of the few good news of the quarter in terms of return was given by **Clear Media**. The Hong Kong company, the undisputed leader in outdoor advertising in China, was taken over on 31 March by a consortium led by Clear Media's own management team and comprising, among others, Ant Financial (the financial arm of the Chinese group **Alibaba**) and the French advertising company **JCDecaux**. The price offered by the consortium was 7.12 HKD per share, which implied a premium of close to 40% on the closing price the day before the announcement.

We have known **Clear Media** for several years now, having been shareholders during this period almost without interruption. As you may know, we invested in the company again in the third quarter of last year after falling sharply in the previous months, due to the poor performance of the business in the face of the Chinese economic slowdown and the reduction in advertising spending by its main customers, who have a technological profile. The measures announced by the company to address the situation, its solid financial position and its capacity to generate cash flow, combined with a very attractive valuation, led to our investment at that time at prices below 4 HKD per share.

Finally, despite the high uncertainty of the moment due to the impact of the coronavirus (right now, practically nobody puts ads on the streets), **Clear Media's** valuation was too appealing for a buyer with the financial strength and patience that this investment requires, allowing us to post a capital gain of 80% in a very short time. **This move should serve as a reminder that, on many occasions, the valuation of companies itself acts as a catalyst. It is very difficult for a €50 bill lying in the street to go unnoticed by everyone.**

HONG KONG

16% of the portfolio (after Clear Media's exit in April)

Holdings: Keck Seng Investments (4.1%), Asia Standard International (4.1%), Value Partners (3.0%), Time Watch Investments (2.5%) and Tai Cheung Holdings (2.1%)

Our exposure to Hong Kong remains relevant in 2020, with five companies in our portfolio: **Tai Cheung Holdings, Time Watch Investments, Keck Seng Investments, Value Partners** and **Asia Standard International**. All of them are, to a greater or

lesser extent, suffering from the impact of the coronavirus pandemic on their businesses.

Time Watch Investments, the leading Chinese watch manufacturer in the domestic market, has been impacted in this first quarter by the closure of almost all its stores during the month of February. According to the CFO, most of them are already open again and traffic in the commercial areas is gradually recovering. **Time Watch**'s financial position is very solid, since the company only pays variable rent for its stores based on the volume of profits, which protects the business at times like the present. Additionally, the company has been able to generate a lot of cash in recent years and currently accumulates a cash position equivalent to 85% of the company's market value.

In addition, **Time Watch** continues to increase its efforts to create shareholder value, which we have seen with the sale of its third-party brand division under a global license—which was incurring significant losses since its acquisition—and also with a notable improvement in the communication with its shareholders, as well as in the information reported. In our opinion, all this will contribute to the market ending up, sooner rather than later, recognising the true value of the company's business.

As for **Asia Standard International**, the company continued its hotel business running, despite the fact that there was virtually no activity in Hong Kong hotels during the quarter due to the effects of the coronavirus in the area, where more than 70% of visitors come from China.

Given its privileged financial position, **Asia Standard International** continued its strategy of buying bonds from real estate-related Chinese companies. The company is taking advantage of a period of heavy selling pressure in the debt market to acquire assets with returns of over 30% in some cases. Despite the risk of these investments, after our conversation with the company and analysing the companies issuing this debt (with levels of debt that are not, in general, of great concern), we think that the strategy of gaining exposure to real estate development through debt, rather than through the direct purchase of the real estate assets, is quite reasonable.

In the case of **Keck Seng Investments**, the worldwide location of its hotels has meant that the impact has been somewhat delayed. In any case, **Keck Seng** announced at the end of March the closure of the W San Francisco, the Sofitel New York and the Delta Hotels by Marriott in Toronto until at least 30 April. Even so, as in previous crises, the group has taken advantage of its solvency to carry out

an opportunistic transaction. In this case, it has acquired 35% of the Sheraton hotel in Ottawa that it did not yet control, with a valuation more than 30% below its appraised value. This is similar to the acquisitions of the San Francisco hotel in 2009 or the acquisition in 2014 of the Manhattan hotel.

HOROS VALUE IBERIA

Stake decreases & exits:

OTHER

Stakes were decreased in Corporación Financiera Alba (2.5% current weight) and Ibersol (1.2%), by 7% of the portfolio in aggregate

Exited from Alantra Partners

In contrast to the specific cases of the international portfolio mentioned above, Horos Value Iberia does not currently own any companies that could face unacceptable liquidity risks. However, we have made some portfolio adjustments as a result of the opportunities offered by the market and the relative upside potential of the individual holdings.

For this reason, we decided to sell our entire stake in **Alantra Partners**, the asset management, advisory and investment banking company. In addition, we decreased our stake in the investment holding company **Corporación Financiera Alba**, as well as in the Portuguese organized foodservice company **Ibersol**.

Stake increases & new stakes:

OTHER

Stakes were increased in Catalana Occidente (7.7% current weight), Sonae (4.8%), Talgo (3.5%) and MERLIN Properties (2.9%), by 8% in aggregate

Among the opportunities provided us by the market this quarter, we have particularly increased our stake in **Catalana Occidente**, **Sonae** and **Talgo**. In addition, we initiated a new stake in **MERLIN Properties SOCIMI** (SOCIMI is the Spanish equivalent of Real Estate Investment Trust or REIT).

Let us start with the Spanish insurance group **Catalana Occidente**. The company's stock price has corrected up to 50% so far this year. In our opinion, the insurance company is more than prepared for any scenario that this crisis may cause. **Catalana Occidente** has two well-differentiated units: traditional insurance and

credit insurance, which account for around 57% and 43% of the business, respectively. In the case of traditional insurance (auto, multi-risk, life and death insurance), this crisis should not have a major impact. However, investors' fear may come from credit insurance, the other side of **Catalana Occidente**'s business. The company—second in the world in terms of market share—insures third parties against the potential non-payment of its clients, so in this current economic environment a significant deterioration in the payment likelihood of the policyholders' clients is to be expected.

However, we have many reasons to believe that **Catalana**'s credit insurance business can overcome this setback without major problems. On the one hand, in 2008 and 2009 the insurance company already demonstrated that this unit was capable of withstanding this type of scenario—without the capital support from the rest of the group—and, furthermore, quickly returning to the path of profitability and earnings growth. On the other hand, the company has been making changes in the way this business unit works by strengthening it operationally, with a much more active approach to risk management. For example, by making extensive use of reinsurance, demanding franchise payments from its clients to cover part of the default or making it easy to cut the policy or raise prices. Finally, this unit has experienced very strong years of late, with historically low combined ratios net of reinsurance, which have allowed it to build up a significant cushion of capital reserves.

To all this, we must add that the company has a family shareholding structure (the Serra family controls more than 60% of the capital), an outstanding track record of value creation via acquisitions, an efficient management of the business (combined ratios below industry average), excess reserves that could reach 800 million euros and a very attractive valuation (P/E of 5x and P/B of 0.6x). For this reason, we have increased our stake in the company, which has become the top holding of Horos Value Iberia.

With regard to **Sonae**, we believe that the Portuguese holding company has a very solid financial position—actually, the company has announced a dividend increase for 2020—and a very trustworthy management team at the helm of each of its businesses. **Sonae** has divisions which should not be significantly affected by the pandemic, such as its food distribution business (Sonae MC), and others that will be affected, such as the division that owns and manages shopping centres (Sonae Sierra), but which have the financial capacity to withstand this difficult environment. However, the market does not seem to share our opinion, given that at current prices and after a decline of nearly 50%, it only attributes value to its distribution division—food and others, such as Worten in technology and JD

Sports/Sprinter in sport— and completely ignores the significant value of the shopping centre business (Sonae Sierra) or its 23.5% stake in the telecommunications company **NOS**. Finally, the Azevedo family controls more than half of the shares, which guarantees a strong alignment of interests with its shareholders.

As for **Talgo**, the rolling stock manufacturing company, we think it is in its best business and financial shape of its recent history to face this crisis. On the one hand, after recording in 2019 orders worth 1.1 billion euros —the highest figure since 2011— and with the new orders obtained so far this year, its backlog has reached 3.8 billion euros, which is a record for **Talgo**. It is also important to note that the company is opening up new markets outside Spain, as 95% of these new contracts are in international markets. In fact, the company has never been so geographically diversified and has been awarded manufacturing contracts in three new markets: Germany (where it was only present in maintenance), Egypt and Denmark, the latter having been awarded in February 2020.

In relation to the economic impact of the coronavirus, **Talgo** has carried out an ERTE (temporary layoffs) for 280 people in Spain. In addition, operations and maintenance levels have fallen both in Spain and in other countries. The company has a net cash position of c.60 million euros and liquidity of 320 million euros, with additional undrawn lines of 70 million euros. **Talgo** has also halted its share buyback programme to adopt an even more conservative stance. As a result, we believe the company is well protected in these uncertain times.

We took advantage of the panic selling to reinitiate a stake in **MERLIN Properties SOCIMI** (Spanish equivalent of REIT). This is a company of which we have been shareholders in the past and whose current valuation seems completely irrational to us. To give you an idea, at the current market price at which **MERLIN** trades, we would be buying its assets at more attractive prices than at the worst time of the previous crisis. In addition, we believe that **MERLIN** has a high quality and highly diversified portfolio of assets, with exposure to offices, shopping centres, logistics centres and hotels. To this we must add the rents charged to **BBVA** for years in more than 700 branches and under very favorable economic conditions. It is also important to note that **MERLIN** does not have relevant debt maturities until 2022. Finally, its latest NAV valued the company at 15.60 euros, much higher than the less than 7 euros at which the share traded at the end of March.

Other major holdings:

Meliá Hotels International

7.6% of the portfolio

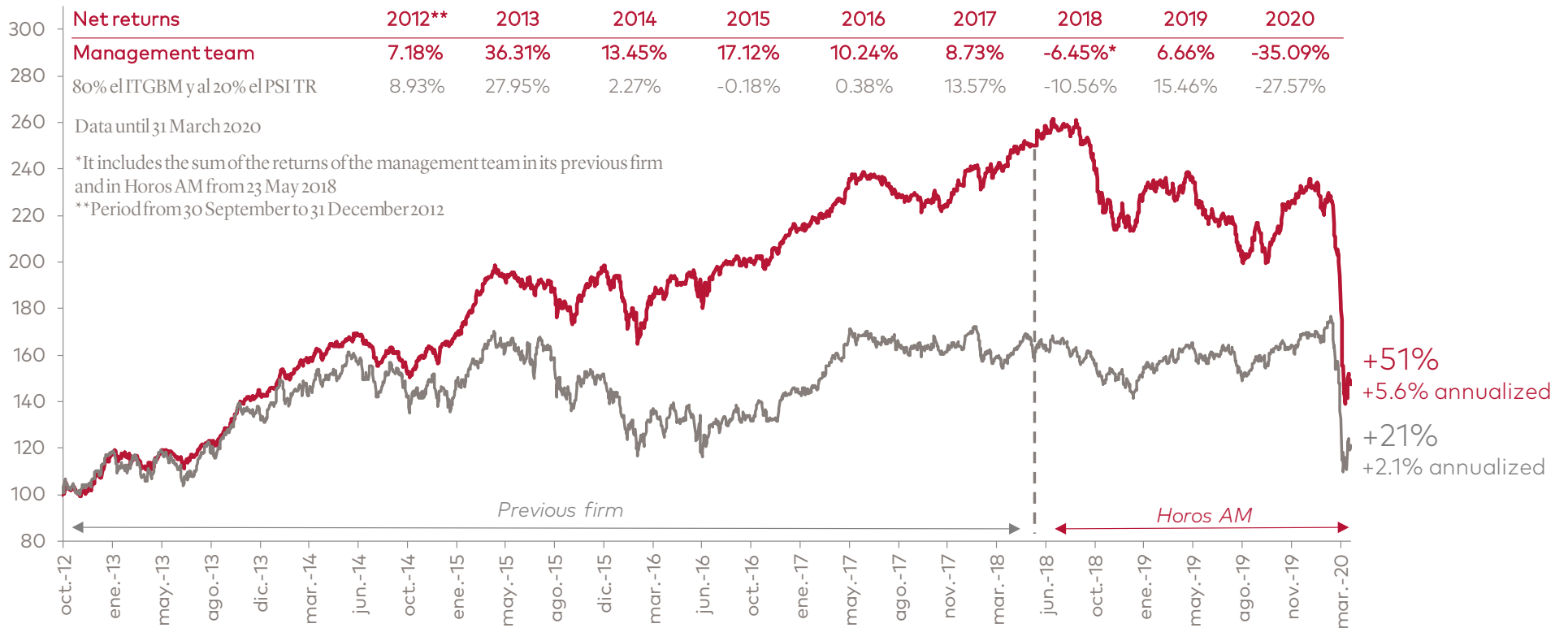
Finally, we would like to comment on the case of **Meliá Hotels International**, as it is one of the main holdings in our portfolios, both in Horos Value Iberia and Horos Value Internacional. The Spanish hotel group lost more than 70% of its stock market value in little more than a month due to the huge impact that the pandemic is having on its business. As in the case of **AerCap**, the huge discount on the value of its hotel assets —of more than 80% at the share price bottom— indicates that investors do not have confidence in the company's ability to withstand this crisis, especially when many of its hotels are not generating a single euro in revenue at the moment. However, several reasons lead us to believe that the investment opportunity is extremely attractive now.

On the one hand, the company has taken measures to alleviate the situation, mostly aimed at reducing personnel expenses, and on the other hand, it has enough liquidity to face several months without making any revenue. That said, the most important thing and where the value of the company lies, can be found in its hotel assets. As of 2018, the valuation of these assets was equivalent to more than 15 euros per share and the stock is trading at around 3 euros at the time of writing. We can discuss whether the 2018 valuation today makes sense and whether it was done close to the peak of the cycle, but it is clear to us that these hotels are worth several times the market value of **Meliá** today. If the situation so requires, the company can divest some of its assets or use them as collateral to obtain financing. As is the case with most of our holdings, having a management team with a very significant stake in the company —the Escarrer family controls more than 50% of the shares— gives us the peace of mind of knowing that all decisions will be taken with the aim of maximising shareholder value.

Annex

Returns

Historical returns of the management team in the **iberian strategy**

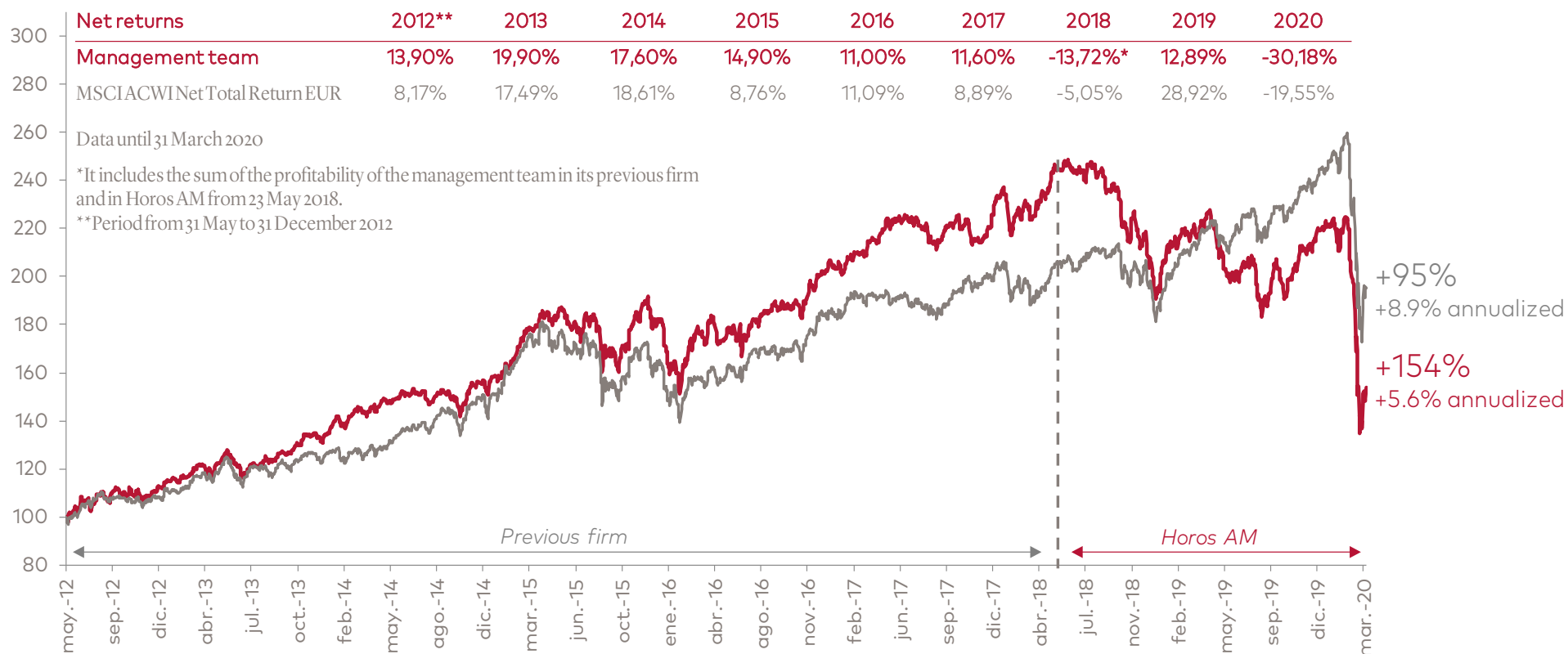


Past performance is no guarantee of future performance. The Fund's investments are subject to market fluctuations and other risks inherent to investing in securities, so the acquisition of the Fund and the returns obtained may vary both upwards and downwards and an investor may not recoup the amount initially invested. Decisions to invest or divest in the Fund must be made by the investor in accordance with the legal documents at all times, and in particular on the basis of the Regulations and the Fundamental Data for the Investor (DFI) of each Fund, accompanied, where appropriate, by the Annual Report and the last quarterly Report. All this information, and any others, will be available to you at the headquarters of the Manager and through the website:

www.horosam.com

Returns

Historical returns of the management team in the international strategy



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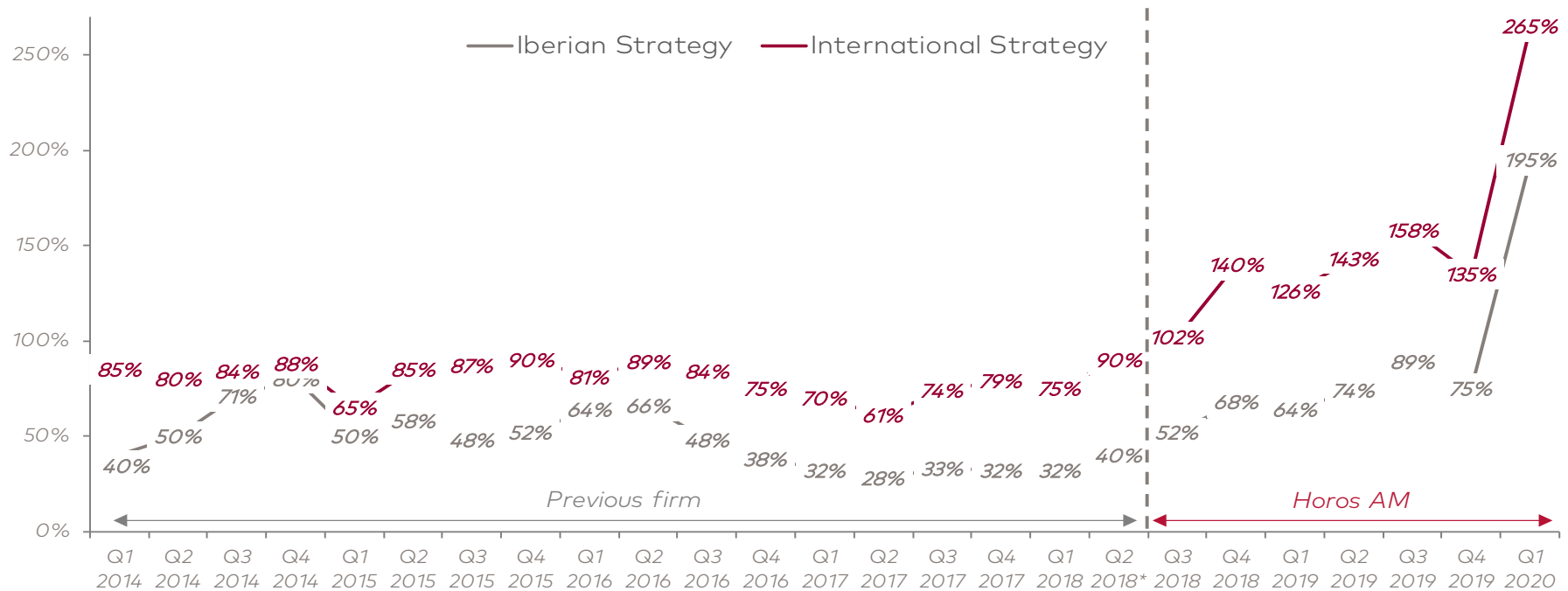
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Upside potential

Historical potential of the management team

Data from 31 March 2014 to 31 March 2020

*Until 21 May 2018 includes the potential of the management team in its previous firm and since then in Horos AM.



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