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ASSET MANAGE-MENT

ANNUAL LETTER TO OUR CO-INVESTORS

JANUARY 2019

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Dear co-investor,

We end a year that has marked the beginning of a very exciting project for all of us who make up the Horos team. It has been a tough but very rewarding start, demanding many hours of work and dedication on the part of each of the company's employees. Thank you and congratulations to each of them.

Thanks also to the more than 2,000 investors who have decided to entrust us with their savings. In a year with such volatility and correction for the markets, your commitment and confidence give us the energy to continue working with the same enthusiasm and dedication as that of the first day.

However, not everything has been a joy in this short period of time. In 2018, we have recognised two investment mistakes which we will discuss in depth in this letter. They won't be the first or the last mistakes we commit. Analysing and learning from them is part of our work and will contribute to improving our investment process. We could not make them public or dedicate a couple of lines of explanation to them in the portfolio movements section, but, as you well know, we want transparency to always be our hallmark. If you understand what we do and why we do it (and that includes when we make mistakes), it will be easier for you to accompany us through the good and bad times of the market and our portfolios. This is the only way to take advantage of the long-term benefits and attractive potential of our funds.

My best wishes for 2019.

Yours sincerely,

Javier Ruiz, CFA
Chief Investment Officer
Horos Asset Management

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The importance of learning from mistakes

Honesty is the fastest way to prevent a mistake from turning into a failure
— James Altucher

What is an investment mistake? According to the dictionary of the Spanish Royal Academy of Language, a mistake is a *wrong or misguided action*. If we apply this definition to the world of investment, we must conclude that a mistake occurs when the investment thesis (*action*) is not fulfilled (*wrong or misguided*), **regardless of whether the return we have obtained is positive or negative**. Understanding this is of vital importance in order to be able to continuously improve as investors. We should not judge an investment solely on the basis of the profit it has brought us. You'll agree that even a three-year-old boy who chooses companies at random can make money on the stock market with some of his investments, but never in a sustainable way. How then can we evaluate whether an investment has been successful or not? By analysing the steps taken to make that investment, that is, studying whether the **investment process** has been the right one.

Michael J. Mauboussin, one of the analysts who has influenced us most as investors, comments in his book "More than you know" that, in all probabilistic fields, such as betting games or investment, we should focus on the decision-making process and not on the short-term result we achieve, **evaluating the process with the results obtained in the long-term**. There will be occasions where the results are deservedly positive and others where they occur purely by chance. Likewise, we may encounter negative outcomes as a result of a bad decision, but also other negative ones caused by scenarios with a very low probability of occurring. A casino is a clear example of this. There may be periods of good fortune during which players win money, but in the long run, the process ensures that the "house" always wins.[1]

Given that the steps taken in decision-making are the most important to obtaining satisfactory returns in the long term, it is essential to detect an investment mistake as soon as possible and in particular study thoroughly why it has occurred, learn from it and thus improve the investment process. This painful (admitting a mistake goes against our human nature) but also enriching analysis, allows us to evolve as investors and reduce the number of mistakes we may make in the future.

1 We'll ignore famous cases like Edward Thorp who consistently beat casinos playing Black Jack and roulette, as he relates in his wonderful biography "A Man for All Markets".

The checklist

No wise pilot, no matter how great his talent or experience, fails to use his checklist
— Charlie Munger

One of the best tools we can use to optimise the investment process is the checklist. The checklist has its origin in the aviation industry when a new Boeing aircraft model crashed during an exhibition in the 1930s. In the subsequent investigation it was discovered that mechanical failure had not caused the tragic accident. Boeing concluded that the complexity of the new aircraft had caused the experienced pilot to forget some of the steps in the take-off phase. Since then checklists have been used to minimise human errors in the piloting of aircraft.

As you know, the investment process that Alejandro, Miguel and I use at Horos is based on five principles that, ideally, the companies that we have in our funds should comply with. By way of example and without being exhaustive, some of the questions we try to answer when analysing a company would be the following:

- Companies that are within our **circle of competence**: Is it a changing industry or is it beyond our capabilities to analyse? Can we visualise what the sector will be like in a few years?

- Businesses that have **competitive advantages and/or long-lasting entry barriers**: Does the company have a stable and/or growing market share? How are the rest of the competitors evolving? How could you destroy this business if you had the financial capacity to try?

- Companies with a **sound balance sheet**: Does the company currently have a net cash position? Otherwise, is it highly likely that it will have one in three years? Is its debt tied to future cash flows and/or do it have assets to support that debt? Is the business predictable and stable?

- Businesses run by **good capital allocators**: Do they continually invest in strengthening the competitive advantages of the business? Do they make acquisitions of other companies at attractive prices? How do they remunerate the shareholder and why?

- The valuation must provide a **high margin of safety**: What exit multiple does the business deserve? How likely is it that the worst-case scenario will come true? Is it tolerable? How attractive is the risk-return trade-off? What conviction do we have in our valuation assumptions?

Although many of the questions we ask ourselves are quantifiable, such as a company's level of debt, others are not so quantifiable, such as the future analysis of an industry, the quality we think a business has or what valuation we believe a company should be given by the market. For this reason, although historically some of the mistakes we have made as investors were related to over-indebted companies, in recent years we have paid more attention to the qualitative aspects of companies and, in particular, to the impact that technological advances have on the companies and the industries in which they operate. There is a great component of subjectivity in our investment process and it is in this component that we must be especially alert in order to avoid falling into significant mistakes that translate into big losses for our funds. No such mistake has occurred this year. The two investment mistakes we have made are connected to the fourth point of our checklist: capital allocation.

The *outsider* or when the jockey makes the difference

Two companies with identical operating results and different approaches to allocating capital will derive two very different long-term outcomes for shareholders

- William N. Thorndike

The sentence you have just read belongs to "The Outsiders", a highly recommended book in which William Thorndike teaches us, through eight real examples, how the capital allocation of a company's managers can make a big difference for its shareholders. As Thorndike explains, a company's management teams have **five fundamental choices when it comes to allocating capital**. Specifically, they can reinvest in the business, acquire other companies, pay down debt, issue dividends and repurchase their own shares. The choices made are just as important as the way they are financed. Issuing debt, increasing capital or using the cash internally generated by the business will not have the same impact on the shareholder. Therefore, capital allocation is not a trivial issue and must be given the attention it deserves if we are to have a sound investment process.

One of the ways to analyse capital allocation in companies is to study the **decisions that managers have made in the past** and assess whether they have created or destroyed value for their shareholders. If there is one sector in which it is vital to

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have skilled capital allocators, it is banking. By having a highly leveraged balance sheet, any small change in the value of their assets has a much greater impact on the equity of these entities. However, good capital allocators have been more the exception than the norm in banks. For example, Spanish banks have acquired other entities in peak cycle at exorbitant prices and increased capital to maintain a dividend that is clearly unsustainable, which have led to permanent capital losses for their shareholders. This is one of the (many) reasons why we have historically avoided exposure to the banking sector.

What would be an example of value-creating capital allocation for shareholders? You don't have to go far to find it. **In Spain, we have several cases of capital allocators who have made a difference over the years**. Companies such as Barón de Ley (with its continuous repurchase of its own shares at very attractive prices), Catalana Occidente (with its prudent capital allocation and acquisitions of other entities at inexpensive multiples) and Altia Consultores (with very attractive acquisitions and an obsession with cost efficiency) are examples of how capital allocation can make a difference in terms of returns for shareholders.

However, while a history of good capital allocation is a good starting point, it is no guarantee that it will remain good in the future. On the other hand, there will be times when we are dealing with companies where there is no history that allows us to draw any conclusions or where the management team has changed recently. So how do we know whether or not a management team will make decisions that generate or at least do not destroy value for its shareholders? By studying whether or not there is a real **alignment of interests with its shareholders**.

The *skin in the game* or when we all win and lose

What matters isn't what a person has or doesn't have; it is what he or she is afraid of losing
— Nassim N. Taleb

The *skin in the game* is another concept recently popularised by Nassim Taleb, an author we spoke about in the last quarterly letter when we explained the ideas of convexity and optionality (read here), in his book "Skin in the Game: Hidden Asymmetries in Daily Life". However, it is not a new concept in the world of investment. Warren Buffett, the most successful and important investor in history, has defended for years the idea that **managers should be shareholders of the companies they manage** and bet their money along with the rest of the

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shareholders who have trusted in their management. In this way, they will have a clear incentive not to make decisions that destroy value for their shareholders.

For this reason, when looking for companies with good or correct capital allocation, we often find companies in which the ownership is controlled by its management team, which is often made up of its own founding family. Of the fewer than 50 companies in which we invest through our Horos Value Iberia and Horos Value International funds, approximately 30 have a shareholder base controlled by its management team or with a significant stake which means that they are betting their own hides, giving us peace of mind as to what we can expect from their future capital allocation. Corticeira Amorim (75% of the shares held by the Amorim family), the aforementioned Barón de Ley (70% owned by its CEO, Eduardo Santos-Ruiz) or Keck Seng Investments (75% owned by the Ho family) are clear examples of investments in which the management team have skin in the game on every decision they make, which has had a very positive impact on the creation of value for their shareholders.

However, investing exclusively in family-owned companies, even though it has the benefits mentioned above, can lead us to miss out on other great investment opportunities. Does it make sense to stop investing in commodity-related companies, for example, where we see great potential for revaluation just because in many cases, they do not have managers who own a significant stake in the company they run? Obviously not. How can we try to ensure, in these cases, that the management team will make the appropriate or non-harmful decisions for shareholders? By studying the company's incentive system in the remuneration of the management.

The incentive as a carrot and stick of the management

Show me the incentive and I'll show you the outcome
— Charlie Munger

The great Austrian economist Ludwig von Mises said that every human action is triggered by a state of uneasiness or dissatisfaction, or why else would it occur? Human behaviour is therefore based on seeking to achieve certain goals or objectives and using all the means at our disposal to achieve them. **The problem arises when these objectives are not correctly predefined and condition our behaviour, triggering unwanted actions**. We find a typical example in politics. The objective of all politicians is to maximise their number of voters and to remain in power, whereas their priority objective may be to maximise the well-being of

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citizens, even if it may cost them votes and few years of legislating. Without an adequate incentive, the politician always tries to keep the voter happy with populist and short-term measures, at the cost of future problems for a society that he or she will not have to deal with in his or her mandate (unmanageable debts, unsustainable pension system, increasingly higher taxes, etc.).

The business world is no stranger to the power of objectives or incentives. **A management team with an incentive system whose ultimate objective is to generate value for its shareholders will tend to perform good capital allocation and vice versa**. A good remuneration system should have long-term incentives aimed at maximising shareholder returns. This can be achieved by establishing direct incentives, such as establishing variable remuneration based on the evolution of the company's stock price, in absolute terms or comparing to its peers. While the market may behave irrationally for a long time, we prefer indirect incentives focused on long-term business profitability, cash generation and the like. In the end, if the business goes well, the stock will end up reflecting this in its price and will stop managers focussing excessively on the evolution of their company on the stock exchange.

On the other hand, long-term remuneration systems based solely on business growth can lead to capital allocation focused on making continuous expansions, both organic and via acquisitions of other entities, generally financed with excessive and expensive debt or through capital increases that destroy value for their shareholders. We are not saying that we should avoid companies that continually make acquisitions. We simply have to analyse whether these acquisitions are generating value and whether the incentives may be playing a perverse role in the company's capital allocation. **At Horos Value International, we have companies that make several acquisitions of other businesses each year, always at very attractive prices and with a proven ability to obtain significant returns from those acquisitions**. Vertu Motors or Pendragon are examples of such companies.

Finally, an interesting exercise is to analyse **what percentage of managers' total remuneration is fixed salary** and whether or not they are **buying shares** for themselves in significant amounts. The first can lead to complacency and paralysis in their decisions (if I earn a good salary, why should I change anything?). The second is a clear sign of commitment to the shareholder (there is no better alignment with the shareholder than being one of them) and, furthermore, it can give us information on whether the manager, who knows first-hand how the business is going, finds the valuation of his company attractive to invest in. These two factors played against us in the first of the investment mistakes that we are going to study.

Zeal Network or when *they* win the big Jackpot

The proposed acquisition of Lotto24 and announced change in strategic direction of the Company is likely to predominantly benefit the largest cross-shareholders and is not in the interest of minority shareholders
— Burren Capital Advisors

Zeal Network, a secondary lottery operator of which we have been shareholders for more than six years, announced on 19 November last year the acquisition of Lotto24, Germany's leading online primary lottery broker. **A transforming operation that is very much defended by its management team and which, nevertheless, we believe destroys value for its shareholders, including us**. To understand why we think this is a wrong move, we need to take a look at the history of the company and how it got here.

Until 2008, Tipp24 (former name of Zeal Network) operated as an online lottery broker, selling official state game tickets and earning a commission on each sale. It was a simple and growing business, in which Tipp24 became the undisputed leader in Germany, with a market share of 60% and nearly two and a half million registered users. However, its fate changed radically when the German regulator, in a blatantly paternalistic move, decided to ban online gambling and its advertising, including lottery. The company therefore found itself in an unsustainable situation, as its main activity became illegal. To stay afloat, **Tipp24 found an innovative business solution, becoming a secondary lottery operator and spinning-off its traditional business (Lotto24)**. Not being able to carry out its new activity in Germany, Tipp24 changed its social domicile and head office to the United Kingdom and changed its name to Zeal Network.

But what is this new line of business? Basically, Zeal Network created a *parallel* lottery (hence the name secondary) that replicates the operation and prizes of the *official* lottery (primary). Thus, a player who plays EuroMillions from the Zeal Network platform is not really playing the state game, but a game created by Zeal in the image and likeness of the official one. For practical purposes, the player does not perceive any difference. For Zeal Network, however, the difference is abysmal as a business model. When faced with potential prizes, Zeal always maintains expensive contracted hedging, which allows it to have to pay out "only" some thirty million a year in the worst-case scenario (an exercise with an abundance of important prizes). Therefore, it must always maintain a relevant cash position that does not hinder the normal course of business. In return for this, the business is much more lucrative than the traditional one. **As a secondary lottery operator, Zeal's gross margin averages 50%, compared to just over 10% for the classic online lottery broker, such as Lotto24**, whose business became legal again, including advertising, in 2013. This has allowed Zeal to generate around 180 million of free cash flow from 2012 to today, while Lotto24 has not managed to stop losing money until 2017, *burning* 40 million euros in the period. In addition, the company has been including successful games from other lotteries such as Powerball or Mega Millions, from the United States, with promising growth prospects and initiated expansions into other markets, with an important focus on social lotteries, such as UNICEF.

Not everything has been good in this period. Since 2015, the German regulator has been claiming the corresponding VAT for the sale of electronically supplied services to German citizens, including the sale of lottery tickets in this claim. As we have commented on other occasions, this measure clashes with the regulation of the European Union itself, so our base scenario has always assigned a probability of less than 50% against the company, in line with what Zeal itself defends. Despite this, **this new uncertainty has weighed on Zeal's stock market value in recent years, placing its valuation at an increasingly depressed threshold** and pushing its stock price to several-year lows by the end of 2018.

Faced with an increasingly uncertain regulatory environment, Zeal Network managers have found a new solution—this time less innovative—to this complicated situation that the company has been navigating for some time. Zeal has decided to return to its roots and once again become an online primary lottery broker, ending Germany's secondary lottery business. However, instead of applying for the primary broker license, it has opted for the fastest way: **to launch a takeover bid on Lotto24**.

So far, one could say that the move makes total sense and that the managers, looking out for the interests of their shareholders, have decided to do the only thing they can in this hostile regulatory environment. As the saying goes, the devil is in the details and, in this case, we don't have to do much digging to find some points that lead us to question the corporate move. Specifically:

- End of secondary lottery business.

Zeal Network closes a very lucrative business (50% gross margin and cash generator), although subject to uncertainties, for a much less profitable one (approx. 10% gross margin) by necessity on a larger scale (not yet cash generating). The company's main argument for making this move is that the regulator will eventually make Zeal's current business non-viable.

- Hostile regulatory environment.

One of the issues that has surprised us the most is the sudden change in the company's discourse in relation to the regulatory environment. Zeal, at no time (we have been in direct communication with them for years, via email, phone calls and meetings in London and Madrid), not even in the presentation of results that they made three weeks before the announcement of the takeover bid, mentioned or insinuated that the regulation was going to become as complicated as they now claim. Is this an opportunistic argument to defend the corporate move?

- Broker license request.

Even assuming that conversion to traditional brokerage is inevitable, why didn't they apply for a brokerage license and continue the secondary lottery business? Zeal makes again the argument that the regulator would make such a move impossible and would not allow a lottery broker to also have a secondary lottery business. So why not apply for the license and close the secondary lottery business once it's been granted? Same answer.

- The corporate move.

As we explained in the section of the letter devoted to capital allocation, a good manager must always seek the alternative that generates the most value for his or her shareholders. Our feeling is that the Zeal directors have not done that job. On the one hand, it does not seem that they have studied the possibility of continuing on as before and waiting to see whether or not this negative scenario that suddenly anticipated will actually materialise. At the end of 2018, Zeal will end the year with some 125 million euros in cash, compared to a stock market valuation of 200 million euros. Taking into account Zeal's cash generation in a normal year (approximately 30 million euros), they would end 2019 with 155 million, not taking into account potential prize payments or a negative outcome of the German VAT claim. **Are we sure that there are no other attractive alternatives for shareholders other than destroying their current business and making it less profitable?**

In addition, the price paid for Lotto24 seems to us, at the very least, questionable. Zeal Network will pay with new shares for the acquisition of Lotto24, leaving the current shareholders of Zeal with approximately one-third of the new company.

The **expansion is carried out at the lowest prices of the last decade and with the company valued at levels never seen before** (EV'20/FCF normalised of 1x in our base case scenario). Not only that, Lotto24 is trading close to its historical highs and at a valuation that, in our opinion, includes all the benefits expected for their business in the coming years.

When we inquire about these points, Zeal argues that it was the best option given the alternatives and that they have fought a lot to ensure the purchase price was not even less attractive. In fact, they argue that the price paid is very good and that the value created for the shareholders will be very significant. We agree with them that the new company has significant potential for the coming years, being the leading German online lottery sales player and benefiting from the greater future penetration of this sales channel in the total lottery market in Germany. However, **we question the renunciation of Zeal's current higher potential, the cost to the shareholders and the argued inevitability to justify the operation**.

- The VAT base case scenario.

Zeal Network has always claimed (and it is reflected in its balance sheet) that the most likely scenario for the company is that it will not to have to pay VAT on the sale of lottery to German players and, therefore, would end up distributing the excess cash retained in insurance against a negative resolution on VAT.

As reported by the company in the last publication of results, it is likely that a first resolution will be known in the first quarter of this new year. It does not appear that Zeal intends to distribute this potential excess cash to its current shareholders, so we will be "giving away" part of the expected dividend to Lotto24 shareholders.

- Surprising cost reduction.

At the same time as announcing the takeover bid for Lotto24, Zeal communicated to the market a cost saving plan that will allow it to reduce costs by 4 million euros per year. The moment of the announcement never ceases to surprise and the fact that it had not been made before, bearing in mind that the company claims that it will be able to carry out this savings plan quickly and without taking drastic measures. We're talking about more than 10% of the company's one-year cash generation and 2% of its stock market value. It wouldn't have been wrong for them to start this "simple" plan a little earlier.

- Existence of cross-shareholders.

Finally, the darkest point of this transaction is found in the ownership of both companies. Zeal Network and Lotto24 share their two main shareholders, the Günther Group and Working Capital Advisors, which own 15% of Zeal's shares and 60% of Lotto24's shares. The Günther Group has been a shareholder of Zeal Network and Lotto24 for years. However, Working Capital is a totally unknown shareholder who has taken a very significant position in both companies in a short period of time. Some of Zeal's shareholders, such as its competitor Lottoland and the management company Burren Capital Advisors, have requested by means of public letters the identification of this shareholder and whether it worked in concert with or even for the Günther Group in this process. Be that as it may, we cannot help but wonder whether the movement has been orchestrated by Zeal's directors or by this group of shareholders with unexplained interests in both companies.

In light of this profound review of all that has happened in this investment, you may be wondering why we consider it a mistake. The answer is that we did not give enough importance to the study we did on the (non-existent) alignment of interests of the management team with its shareholders. The aspects that had always caught our attention were the following:

- **Excessive compensation**: Key executives such as Helmut Becker (CEO), Jonas Mattsson (CFO) and Susan Standiford (former COO of the company) received in total, between 2.7 million euros and 3.5 million euros in 2015, 2016 and 2017. The 2017 compensation for these executives accounted for about 15% of the company's operating profit. This is not an inconsiderable figure.

- **Barely significant long-term incentive**: in addition to very high remuneration, long-term incentives account for a maximum of 25% of the total and have rarely been met, as they are linked to the evolution of earnings per share and the price level of Zeal's stock price.

- **No *skin in the game***: not only do they have no remuneration to ensure the shareholders' best interests, but managers have practically no exposure to the company they run. At the end of 2017, Mr Becker held 1,392 shares and Mr Mattsson 1,000 shares. That is to say, between twenty thousand and thirty thousand euros invested, as opposed to an annual salary of one million euros. To show—according to them—commitment to the new project, they have just bought shares for between eighty and one hundred thousand euros. This is still a very insignificant figure in relation to the salary received by both.

Therefore, there were signs indicating that, faced with a significant decision in terms of capital allocation for shareholders, managers would prioritise their interests over those of shareholders. Both Mr Becker and Mr Mattsson will continue in the new company with the same positions as CEO and CFO, although they will focus exclusively on the new business lines that Zeal Network has today. It's certainly a lesson we can't forget: **no matter how cheap a company is, the incentives can work against us**.

Finally, I would like to point out that we have not liquidated our investment in the company. Our intention is to vote **against** the proposed capital increase to acquire Lotto24 and wait for events (in January, Lottoland announced its intention to launch a purchase offer for certain Zeal assets) to make a decision. The margin of safety is so high that we think it is the best option as shareholders at this time.

OHL or when reputation is everything

In the world of business, bad news often surfaces serially: you see a cockroach in your kitchen; as the days go by, you meet his relatives
- Warren Buffett

The second investment mistake that we are going to comment on is even more painful because of the way in which it has occurred and, especially, because of its impact on the performance of our funds. The mistake relates to OHL, an investment that we have bet on over the last year and whose deterioration, anticipated in the last quarterly letter, has led to its liquidation.

In the beginning, it seemed such an easy and clear investment that, as it turned out, it was too good to be true. The sale of OHL Concesiones meant an absolute change in the company's financial profile, leaving its balance sheet with a very important net cash position, to the point that there were times when this cash, even assuming future outflows for working capital needs and losses for ongoing projects, was higher than the market cap of OHL. This caught our attention. We did not understand what could be producing this apparent inefficiency in the market. **We were well aware of the past decisions of the management team, but the margin of safety was, at the time and with the data on the table, so clear that we decided to make a very significant investment in the company**. In a certain sense, it can be said that we went like bees to a jar of honey, without questioning whether there was a catch.

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What attracted us to this investment? On the one hand, as we have already mentioned, its important cash position. On the other hand, the theoretical valuation of real estate assets such as the Canalejas Project or Ciudad Mayakoba. **The sum of the cash value and real estate assets gave us the margin of safety to justify this investment**. In addition, OHL has a construction business. This was the line of business that we didn't like, as it hadn't demonstrated the ability to obtain satisfactory returns over the years. In fact, one of the ultimately justified fears of the market was the so-called legacy projects: old and problematic construction projects, where it was not clear what potential damage could be generated in terms of extraordinary expenses for the company. However, the "new" approach of the management team, giving the future impact figures of the *legacy* projects and focusing exclusively on future projects that were profitable, convinced us of the attractiveness of the investment. This was our downfall.

Already in the first quarter, the company published results that showed some uncertainty in the valuation, due to suffering a greater increase in working capital needs than expected. Also, we couldn't quite understand why they didn't use the cash to pay a bigger dividend. However, the truly worrying moment began with the release of second quarter results, released at the end of September last year. On the one hand, OHL announced extraordinary losses of 77 million euros, due to additional costs linked to the final phase of one of the group's legacy projects: the CHUM hospital in Canada. On the other hand, OHL sold its Mayakoba assets in October for 88 million euros, when their book value was around 150 million euros. **These two setbacks drastically reduced the margin of safety in the investment, deteriorating our investment thesis and demonstrating that the management team might not be being sincere with the market**, nor with legacy projects, nor with their valuation of real estate assets. Is there be anything else we didn't know? It wouldn't be long before we found out.

In 2008, along with the Egyptian company Orascom, OHL was awarded a contract for the construction of the Sidra Hospital in Qatar. In 2014, the Qatar Foundation rescinded the contract, alleging non-compliance with delivery deadlines and work schedules. OHL initiated an arbitration claiming, after several reductions, between 400 and 500 million euros. Of this amount, the company has always estimated 200 million as the amount likely to be collected. However, at the end of November last year, the Court of the International Chamber of Commerce issued a partial award recognising a 44 million right of collection for OHL. Since we did not understand what this partial amount meant in relation to the total amount claimed by the company, we talked to OHL to seek clarification. The answers left us, to say the least, dissatisfied and with the feeling, again, that not all the information was being given. After having significantly reduced our investment with the release of the second quarter results, we fully liquidated our investment after this conversation with the company.

Where did we make the mistake and where do we need to improve the process? Without a doubt, we have to be much more demanding regarding the reputation of the management teams that we associate with. No matter how high the margin of safety is in an investment, the numbers can fool us if they are inflated by the company, taking advantage of accounting standards, or by hiding information relevant to the market. **We can't control if the numbers are not correct. What we can control is which management teams we partner with.**

Current Affairs

As far as Horos' most notable current affairs are concerned, this quarter we have continued our work to publicise our project and investment philosophy. On the one hand, our manager Alejandro Martín published a new video on our YouTube channel (watch channel), in which he explains our investment in Keck Seng Investments (watch video), one of the main Horos Value International's holdings. On the other hand we, the entire Horos management team, had the pleasure in November of presenting our project at Value School (watch video).

In addition, I would like to highlight two of the interviews that we conducted in this period for being somewhat "different" from the usual. The first of them would be Norel Ventura's interview of Alejandro, in which he explains, among many other things, how he arrived at the *value* philosophy (read interview). The second would be the Estrategias de Inversión's (Investment Strategies) interview of José María Concejo, our CEO, in which he explains the Horos project (read interview).

In this last quarter we informed the market that, as of 1 November 2018, Horos assumes the cost of analysis contracted by the manager, once the MiFID II directive has been transposed. A step we are taking as we had always planned to since the creation of the project and one that, through the using of our funds, demonstrates our commitment.

Finally, I would like to welcome Laura Ruiz to the Horos investor relations team. Her enthusiasm and commitment are an example to all of us who make up this family.

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Horos Value Iberia

The fund can invest up to 20% in securities listed in Portugal and at least 80% in securities listed in Spain. In addition, it can invest up to 10% in Spanish or Portuguese companies listed on other markets.

Horos Value Iberia's returned -11.0% in the fourth quarter, compared to its benchmark index, which returned -8.9%. Since its inception on 21 May to 31 December, the fund's cumulative return has been -13.1%. In the same period, its benchmark performance was -13.6%. The results achieved in such a short period of time are merely anecdotal and should be considered as such.

The most positive contributors in the quarter were **Greenalia** and **Grenergy**, our two holdings in the renewable energy sector. These are two companies that were trading, at the time of our entry, with a large discount on a conservative valuation of their projects. The market has been recognising this value with an important rally in the period.

On the negative side, **OHL**, **Aperam** and **Ercros** are notable. The last two have been hampered by the indiscriminate fall of all cyclical companies on the stock market. In both cases, it seems to us that the margin of safety is very high and protects us from potential adverse scenarios. As for OHL, the continuous negative flow of news (deterioration of working capital, unexpected cost overruns in the final phase of the CHUM Hospital in Canada, the sale of Mayakoba assets at prices well below their book value or the reduced amount of the partial award of the Sidra Hospital in Qatar) has led to a drop in the price of the company's stock price. In this case, we do think that the drop is justified, given the lack of credibility of the messages from its management team. For this reason, we have decided to liquidate our investment and assume the investment mistake.

The fund's portfolio had two entries in the quarter (Gestamp and Greenalia) and four exits (OHL, NOS, Global Dominion and Merlin Properties).

Gestamp is a family-owned company (approximately 60% ownership in the hands of the Riberas family) that supplies components for the automotive sector, especially bodies and chassis, and is one of the global leaders. One of the attractive aspects of the business is its hot stamping technology, today less than twenty percent of its sales, which improves the qualities of the parts produced in terms of strength and weight. These qualities mean that it is gaining market share from cold stamping, which gives the company an interesting growth profile for the coming years and protects it, to a greater extent than the components sector, against future disruptions in this industry.

Greenalia is a family-owned renewable energy company listed on the MAB. The origin of the company is in the forestry sector but is expanding its activity to the energy sector where it is building a 50 MW biomass plant in Galicia and will begin to develop up to 185 MW of wind energy in 2019 awarded in an auction. In addition, the company has a backlog of potential projects to develop between 2021 and 2023 for 1,105 MW, of which 594 MW are wind, 430 MW photovoltaic and 81 MW biomass.

As for portfolio exits, with the exception of OHL, the rest occurred because these investments had an unattractive potential compared to the rest of the alternatives in the portfolio.

We would also like to highlight what has happened at **Barón de Ley**. Its CEO, Eduardo Santos-Ruiz, has launched a takeover bid without exclusion after achieving control of more than 50% of the shareholders at a price of 109 euros. Following the announcement, it continued to acquire shares until it obtained 70% of the total. By having, in our opinion, a potential much higher than 109 euros, we are maintaining our investment and we will not take part in the takeover bid.

At the end of the quarter, **the fund's *theoretical* potential for the next three years was around 68%**, equivalent to an annualised return of 18.9%. For the calculation of this potential, we perform an individual study of each security that makes up the portfolio. These theoretical returns are no guarantee that the fund will perform well over the next three years, but they do give an idea of how attractive the current time is for investing in Horos Value Iberia.

Portfolio Structure

At the end of December, Horos Value Iberia's portfolio is made up of 25 holdings and is concentrated on two relevant blocks. One block, almost **70%** of the invested part of the portfolio is made up of companies that we have known for years, managed by **families with an important presence in the shareholding** (which guarantees an alignment of interests with their shareholders).

The second block **(14%**) is made up of **companies that have been forgotten** or even "hated" by the investment community because they have historically been unfulfilling for shareholders but are very attractive to invest in today.

Horos Value Iberia also invests in **Horos Value Internacional (4.9%**). In this way, the potential of the Iberian fund is increased, rising the quality of the portfolio and generating greater value for our investors in the long-term. Of course, NO commission will be charged on that percentage invested in the house funds.

Lastly, the **cash position** of the fund at the end of the quarter stood at **4%**.

Main Positions

Meliá Hoteles (7.0%, family-owned): hotel group with a presence in more than 40 countries, of which the Escarrer family controls 52% and has been a shareholder for more than 60 years. The company is the leading hotel chain in Latin America and the Caribbean and is the largest global player in resorts and bleisure (a combination of business and leisure). Meliá's objective is to migrate to an asset-light business model, which focusses on the management of hotels without owning them. Currently, hotel management accounts for nearly 30% of EBITDA and they expect to reach 50% in seven years. The interesting thing about this investment lies in the valuation of its hotel assets, much higher than its current market capitalisation, which allows us to take the hotel management business "for free", and what can contribute to the company in the future.

Ercros (7.0%, forgotten): company forgotten by analysts due to the complicated situation it experienced a few years ago. It is an industrial group dedicated to the production of chlorine derivatives (necessary, for example, for the manufacture of PVC), intermediate chemicals (formaldehydes, glues and resins, etc.) and pharmaceuticals (raw materials and intermediary products). After almost ten years of continuous decline in demand for PVC, the capacity shutdowns of the sector in recent years, together with the additional restriction of supply that is taking place, following the ban by the European regulator on the use of mercury technology in chlorine production processes, gives us reasonable expectations for a good evolution of this industry in the coming years.

Renta Corporación (6.6%, forgotten): the company, focussed on acquiring real estate assets for transformation and sale, has gone through a restructuring process, both financial and business (they use options to purchase the properties to be reformed), which avoids risks to the balance sheet that are typical of this industry. In addition, it has recently reached an agreement with APG to manage a SOCIMI, which specialises in the residential assets, for the Dutch pension fund. This SOCIMI has the goal of reaching 1,500 million euros in assets and Renta Corporación charges a 1.5% fee for its management, in addition to owning 3% of the SOCIMI. Finally, it should be noted that we are working hand in hand with a professional and highly experienced management team, which has been able to reinvent its business toward a model of high returns on capital employed.

Semapa (5.0%, family-owned): Portuguese investment vehicle managed by the Queiroz family, which controls close to 70% of the paper company Navigator and 100% of the cement company Secil and the animal by-products treatment company ETSA. We believe that the holding company is trading at an excessive discount compared to the valuation of its assets.

Aperam (5.0%, family-owned): one of the world's leading stainless-steel producers, with strong exposure to Europe and Latin America. After a couple of years of good stock performance, as a result of the rationalisation of the sector's supply and the anti-dumping measures imposed by Europe against Asian producers, the fear of US President Trump's tariffs on this metal and the reprisals taken by Europe have, in our opinion, had an excessively negative impact on the stock.

Horos Value Internacional/ Horos Int. PP

Our international portfolio can invest without geographical restrictions in most of the world's stock exchanges, including the Iberian market. Therefore, Horos Value International and Horos International PP are the products that have the best investment ideas that this management team finds currently available.

Horos Value Internacional returned -17.4% in the fourth quarter, compared to its benchmark index, which returned -11.3%. From its inception on 21 May to 31 December, the fund's cumulative return has been -20.3%. In the same period, its benchmark performance was -8.5%. In the case of Horos Internacional PP, the return has been -21.0%. The difference between the fund and the plan comes from the fact that the plan started its investment process days later. The results obtained in such a short period of time are merely anecdotal and should be considered as such.

In this period, the holdings that have contributed most to the fund's portfolio are **Qiwi**, **Sonae Capital** and **Talgo**. Qiwi has benefited from a release of results in the quarter higher than expected by the market. It is also important to note that the Russian financial services company held its first Investor Day in London last November, which we were pleased to attend, and where they outlined in detail their business plan for the coming years. In the case of Talgo, it won its first regional train contract in Latvia, a milestone for the company. In addition, it announced a very ambitious share repurchase programme of one hundred million euros, which has been very well received by the market.

On the negative side, **OHL**, **Teekay Corporation** and **Ensco** are notable. The last two have been hampered by the vertical drop in the price of oil during the period. In the case of Teekay Corp., the announcement of a lower-than-expected dividend increase by its subsidiary Teekay LNG has also contributed to this poor performance, given Teekay Corp.'s significant financial leverage and dependence on these flows received. In both cases, it seems to us that the margin of safety is very high and protects us from even the potential worst-case scenarios. As for OHL, the continuous negative flow of news (deterioration of working capital, unexpected cost overruns in the final phase of the CHUM Hospital in Canada, the sale of Mayakoba assets at prices well below their book value or the reduced amount of the partial award of the Sidra Hospital in Qatar) has led to a drop in the price of the company's stock price. In this case, we do think that the drop is justified, given the lack of credibility of the messages from its management team. For this reason, we have decided to liquidate our investment and assume the investment mistake.

The international portfolio had a significant entry in the period (Sonae Capital) and three exits (Barón de Ley, OHL, Bolsas y Mercados Españoles).

Sonae Capital is a Portuguese investment vehicle managed by the Azevedo family, which owns real estate assets and operates in the tourism, energy and industrial sectors. The company seeks to invest in Portuguese niche companies that may have an export potential. We believe that the value for the sum of parts of the different businesses is substantially higher than Sonae's current market cap.

As for other portfolio exits, with the exception of OHL, the rest occurred because these investments had an unattractive potential compared to the rest of the alternatives in the portfolio. We would also like to highlight what has happened at **Barón de Ley**. Its CEO, Eduardo Santos-Ruiz, has launched a takeover bid without exclusion after achieving control of more than 50% of the shareholders at a price of 109 euros. Following the announcement, it continued to acquire shares until it obtained 70% of the total. In contrast to Horos Value Iberia, where we maintain the investment and will not take part in the takeover bid, in the international portfolio the current value potential is much lower than that of the other alternatives, so we have proceeded to sell our shares.

At the end of the quarter, **the *theoretical* potential of the international strategy for the next three years was around 140%**, equivalent to an annualised return of 33.9%. For the calculation of this potential, we performed an individual study of each security that makes up the portfolio. These theoretical returns are no guarantee that the fund will perform well over the next three years, but they do give an idea of how attractive the current time is for investing in Horos Value International and Horos International PP.

Portfolio Structure

The portfolio has 32 holdings and four blocks that account for the bulk of it. The main one is made up of **companies linked to raw materials (27%)**, especially uranium, stainless steel and oil. Another important block is the one that includes **forgotten emerging stocks (20%)** or stocks scarcely followed by the investment community, mainly from Asia. Investment in **technology platforms (15%)** with powerful network effects that are still trading at very attractive prices and in UK companies **(12%)**, impacted by the *Brexit*, would be the other two important investment blocks.

Lastly, the **cash position** of the portfolio at the end of the quarter stood at **2.7%.**

Main Positions

Asia Standard International (5.0%, forgotten emerging company): is a Hong Kong investment and property development group that invests in prime areas of Hong Kong as well as major cities in China. More specifically, Asia Standard focusses on real estate development, rentals, hotels and travel, as well as financial instruments related to this activity. The bulk of the ownership is controlled by the Poon family, thus, like Keck Seng, the management team is fully aligned with its shareholders. A complex shareholding structure, as well as an accounting valuation of the assets at acquisition cost far removed from reality, lead to an extraordinary undervaluation of this stock.

Aercap Holdings (4.8%, others): one of the world's leading aircraft leasing companies. This is a business with a high revenue recurrence of income and good future prospects, given the expected growth in aircraft production and demand for the coming years, mainly derived from the needs of developed economies and the expected growth of emerging economies. Although this is a business with significant financial leverage, we believe that the stability of the flows generated by the business, as well as the correct capital allocation in recent years, acquiring ILFC at very attractive prices in 2013 or repurchasing shares at a significant discount, justify investing in a company that achieves historical ROEs of 12% and is trading today with a discount on its book value and at less than 10x earnings.

Keck Seng Investments (4.7%, forgotten emerging company): is a Hong Kong family company founded in the early 1940s by the Ho family, owner of 75% of the vehicle, so its interests are aligned with those of its shareholders. The holding company specialises in the ownership and management of hotels in the United States, China, Japan, Vietnam and Canada. Keck Seng also has an important residential portfolio in Macao that we hope will benefit from the recent opening of the bridge that connects Hong Kong with this city. The poor liquidity of the share or the fact that the assets are valued at acquisition cost on the balance sheet have contributed to a market inefficiency, which in our opinion is unjustified.

Uranium Participation Corporation (4.5%, raw materials): investment vehicle that buys and stores uranium for later sale. Given our positive outlook for uranium prices and the limited cost structure of this vehicle, we have decided to concentrate our investment in this type of company (we are also shareholders in Yellow Cake, a similar vehicle listed in London) and renounce, at these prices, exposure via mining companies, where we would have to assume a greater risk of loss in an adverse scenario, as well as operational risks linked to the management and development of projects and mines.

Naspers (4.5%, platform): South African company that invests in different technological platforms around the world, with exposure to classifieds, food delivery and payments. Naspers controls approximately 31% of Tencent Holdings, China's leading global game distribution company and owner of Weixin (WeChat), the social platform used by over 1 billion users. A unique application that allows users to do everything, such as pay with their mobile phone in any Chinese store, hire a transport service or consume digital content of any kind, without the user having to leave the application. Only the valuation of Tencent is higher than Naspers' market value, which allows us to invest at a discount in this extraordinary company and, in addition, to invest "for free" in the rest of Naspers' interesting platforms.

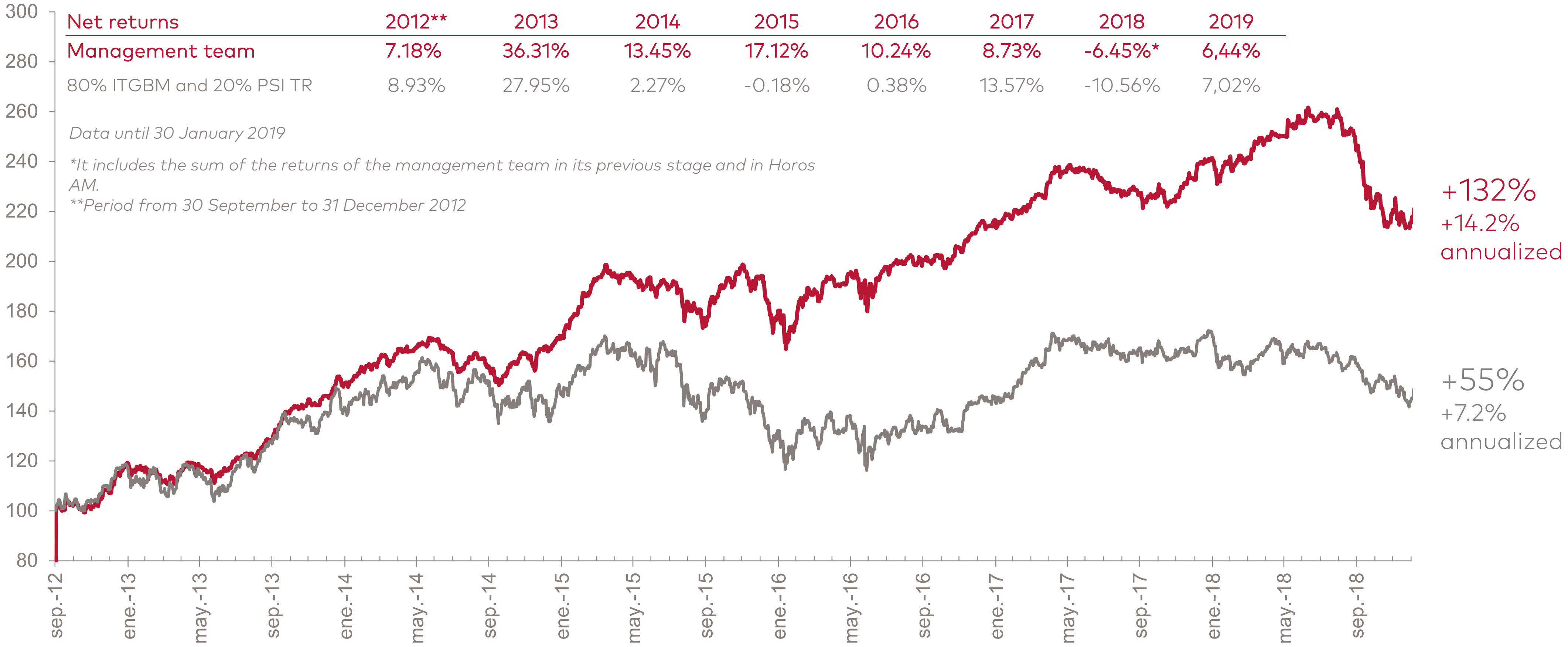
Returns

Historical returns of the management team in the Iberian strategy

Net returns	2012**	2013	2014	2015	2016	2017	2018	2019
Management team	7.18%	36.31%	13.45%	17.12%	10.24%	8.73%	-6.45%*	6,44%
80% ITGBM and 20% PSI TR	8.93%	27.95%	2.27%	-0.18%	0.38%	13.57%	-10.56%	7,02%

Data until 30 January 2019

**It includes the sum of the returns of the management team in its previous stage and in Horos AM.*
***Period from 30 September to 31 December 2012*



Head. Heart. Handcraft

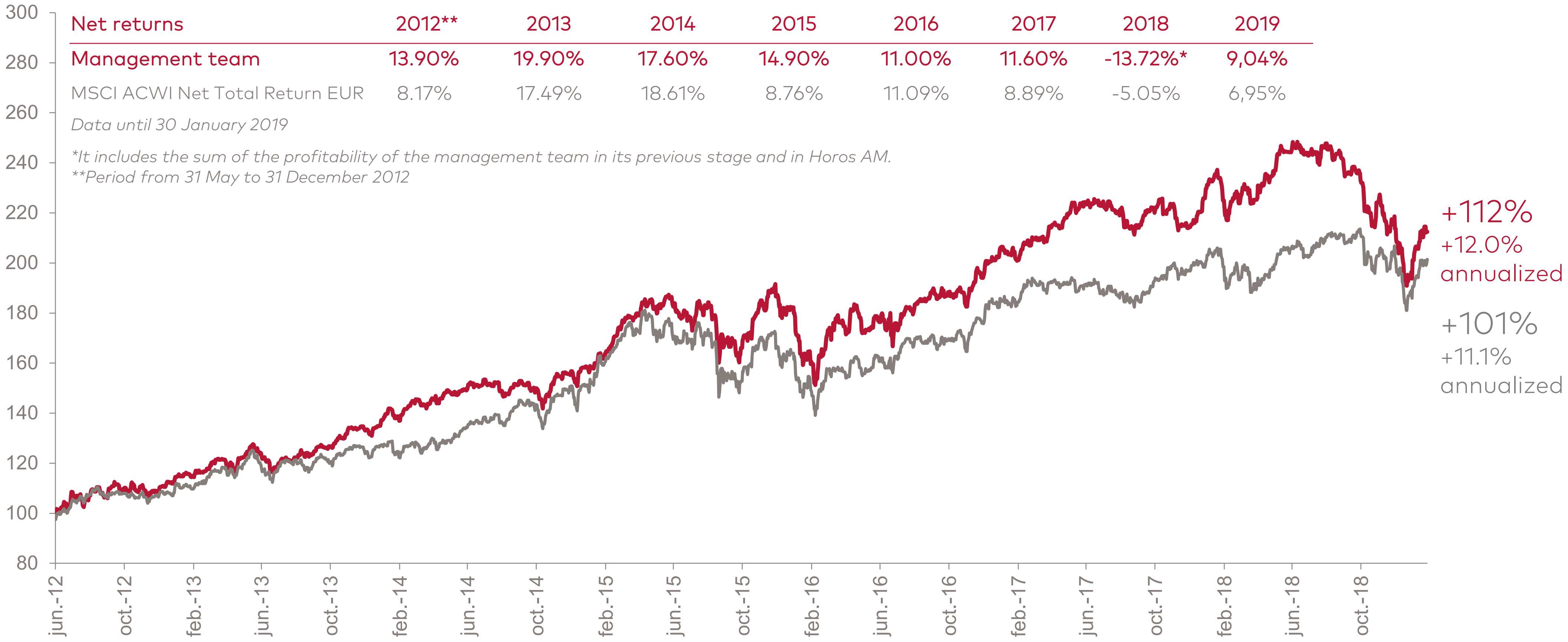
Returns

Historical returns of the management team in the international strategy

Net returns	2012**	2013	2014	2015	2016	2017	2018	2019
Management team	13.90%	19.90%	17.60%	14.90%	11.00%	11.60%	-13.72%*	9,04%
MSCI ACWI Net Total Return EUR	8.17%	17.49%	18.61%	8.76%	11.09%	8.89%	-5.05%	6,95%

Data until 30 January 2019

**It includes the sum of the profitability of the management team in its previous stage and in Horos AM.*
***Period from 31 May to 31 December 2012*



Potential

Historical potential of the management team

Data from 31 March 2014 to 31 December 2018

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