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QUARTERLY LETTER
TO OUR CO-INVESTORS

JULY 2018

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Dear co-investor,

Today we are starting a series of quarterly communications in which we will delve into different aspects of our understanding of investment, as well as the portfolios and different characteristics of our investment products.

As we made clear in the fund presentation letter (read letter), it is very important that you understand how we invest if you are to have a reasonable idea of what to expect as co-investor in our funds. For this reason, this first quarterly letter will be largely devoted to answering the following question: What does it mean to be a value investor? In addition, we will comment on the main positions of our funds and provide update on the weights of the principal themes of their portfolios, as well as their respective potentials.

Finally, I would like to thank each and every one of the more than one thousand people already joining us on this journey. You can count on us to work to meet your expectations and I take this opportunity to remind you that our investor relations team (Juanjo Ferrer and Rodrigo Blanco), as well as the other members of Horos, are entirely at your disposal as necessity demands.

Yours sincerely,

Javier Ruiz, CFA
CIO
Horos Asset Management

What does it mean to be a value investor?

These first few weeks in Horos, Alejandro, Miguel and I have talked with several media outlets eager to learn about this exciting project we have embarked on. Among the countless questions we have tried to answer, perhaps the most often repeated was whether we think there is room for yet another value manager in the Spanish market, with regular allusions to a bubble or fashion for this style of investment. Apart from the fact that we are convinced that the appearance of new projects, regardless of the investment style they have, seems healthy and necessary to us, since it increases the choice for Spanish savers, this line of questioning has led me to wonder whether we are not falling into an excessive generality when it comes to classifying a manager as *value* and I have even come to question whether we ourselves can consider ourselves as such.

You may be surprised by an assertion of this nature. At the end of the day, we have always defended our adoption of this investment style. However, the world of asset management is not immune to society's eagerness to label everything and the investment style followed by managers is something that is always at the forefront of their minds. For example, a manager who has the bulk of his portfolio invested in companies with high earnings growth is quickly classified as *growth*. While investing in companies that trade cheap today, regardless of what the business does in the next few years, is generally considered as *value*. Considering these labels, if you study the portfolio of our Horos Value International fund, you might think that we have a slightly eclectic investment style, with companies with a clear *growth* style (such as Alphabet, the holding company that brings together products such as Google or Youtube) or *value* (such as some of the investments we have in the real estate sector, such as Keck Seng Investments or Asia Standard International, companies with a valuation much lower than their liquidation value). Are we losing focus of the traditional valuation principles of value investing? Or perhaps it is value investing that should evolve with the new business models linked to the Internet?

Is "cheap" the same as "undervalued"?

To the extent that value is based on a simple calculation about ratios, that's a very simplistic definition of value. If people are buying things they haven't analyzed ... it's not likely to end well, Bill Miller

This same debate is being generated at a global level. Value investors as renowned as Bill Miller, who managed the successful Legg Mason Value Trust for decades, have come out to defend publicly with press appearances (read article) their investments in apparently expensive technology companies, according to traditional value metrics. However, as Miller argues, **we cannot fall into the trap of**

associating what is cheap with what is undervalued. It is not the same to invest in a company that is optically cheap today, but with a clearly deteriorating business, than to invest in a company that is trading at less attractive numbers, but with a business with a high and growing cash generation capacity. Companies are dynamic entities and should be valued as such. Otherwise, we will inevitably fall into the dreaded value traps: investments that seem very attractive, but that over time lose value as the business of these companies (and their profits) diminish.

Qualitative business analysis is fundamental in order to minimize potential investment errors, and that's why Alejandro, Miguel and I dedicate the bulk of our analytical work to it. What are the dynamics of the industry in which a company operates? What is its competitive positioning in it? What are the threats to the company and the industry in which it operates? Who manages the entity and how do they manage it?... are some of the questions that we are constantly asking ourselves each day at work. This process is the same for each of the companies in our portfolio, regardless of whether their business is an online advertising platform, a bottle cork factory or a manufacturer of chlorine derivatives. This brings us to the second fundamental debate that is taking place as a result of the *value* label.

Can a value investor invest in technology (at current prices)?

Intangibles now account for over 80% of the average company's market value, Bill Nygren

One of the fund managers I have most admired for years is Bill Nygren. His Oakmark Fund is among those with the greatest long-term returns. However, it is not his performance that should attract our attention, but his flexibility (and historical capacity) as manager to invest in all types of companies, regardless of whether or not they could be considered to belong to one or another investment style. Indeed, Nygren is one of the managers who has recently carried out a public defence (read letter) of his investments in technological companies. As Nygren argues, the classic asset liquidation value metrics, or multiples of current profits, lose all meaning when it comes to valuing businesses without fixed assets and with high R&D or user acquisition costs. Does it make sense to estimate the liquidation value of a company like Alphabet, whose core business comes from advertising solutions for its internet search platforms, video or mobile applications? Does it make sense to estimate its value by today's earnings multiple, when the company is growing at rates of 20% per year, has a net cash position of more than one hundred billion dollars and diluted margins for divisions that have not yet made a profit, such as Youtube or the cloud business?

Of course, the debate is often not even on whether these investments could be catalogued as value. The question is whether it even makes sense that an investor who calls himself value can invest in companies with this type of business. Our approach is very clear on this. **Any company, no matter what it does, must pass through the same filter before we can invest in it**. This filter is none other than our five investment pillars: investing in companies whose business we can foresee in five to ten years, which have some kind of competitive advantage or entry barrier, have a solid financial profile, have good capital allocation and trade at an attractive price. In the case of Alphabet, we are talking about a company that benefits from the structural growth of online advertising, boosted by its leadership in products with more than one billion users that feed back its enormous network effect and a scale that allows it to spend huge amounts of money on research and development (artificial intelligence to improve its algorithms, for example) or on servers to host more and more data. Alphabet also has an enviable net cash position, a management team with outstanding success in capital allocation (purchase of Youtube for 1,650 million dollars or Android for 50 million dollars) and an adjusted valuation of less than 11 times. Is this a value investment? For us it is.

And raw materials are value investments?

Although it is true that the debate in this case is less intense, there is still some debate among the investment community when it comes to classifying this type of investment as value. In fact, the arguments usually given are that this is a macro investment and so one has to make assumptions about the future price of the raw material and predicting the future inevitably increases the margin of error in the analysis. Our vision, however, is very different. To analyse this type of company (and here we are talking about the entire value chain of the industry) we have to understand the **capital cycle** of the raw material in question or, in other words, analyse the current and future situation of market demand and supply.

To see it more clearly, let's do a quick review of the case of uranium, to which we have exposure in our international portfolio. To analyse the supply of this mineral, we have to be able to answer, among others, the following questions: Where are the main uranium resources located? Who is extracting them? Which cost curve does the industry support? Is there overcapacity or not? What can we expect for the next few years from current and future players? Is it profitable at these prices to develop new projects? Why does it exist and what can we expect from the secondary supply of uranium? Whereas, with respect to its demand, some of the questions to be examined would be: Who is demanding uranium today? Who will demand it in the future? Is the price of uranium more important for nuclear power plants or is supply guaranteed? Finally, for the estimation of the future price of uranium, we will always try to be very conservative, and use a price in our models that is reasonably attractive to producers, while taking into account the costs borne by the industry.

Therefore**, to analyse a raw material company we must understand the dynamics of supply and demand and make an assumption about the price of the product sold.**

Basically the same thing we do with any company. Whatever we analyse, the process is exactly the same.

What does it mean to be a value investor?

We could go on for several more pages and talk about other investments that we have in our portfolio and are also a source of debate. However, my objective here is not to make an exhaustive review of each case. The idea of this newsletter is to explain that our investment process follows an identical process for all our investments, regardless of how they are catalogued or labelled. Do we then consider ourselves to be value investors? In answer, I offer the following quote we have up on a wall in our office:

All intelligent investing is value investing — acquiring more than you are paying for, Charlie Munger

Current Affairs

This last month and a half at Horos has been one of enormous intensity and dedication for all of us who are part of this new family. Beginnings are always complicated and I believe that, despite the typical problems of any company taking its first steps, what has been achieved so far is remarkable.

At the moment, we have more than one thousand co-investors and assets close to 30 million euros. In terms of communication, we have significant presence in the most important social networks (more than twelve hundred followers on Twitter) and we have recently opened a channel on the video platform Youtube (watch channel). In addition, we have appeared in several media outlets presenting the Horos AM project (view news) and produced a webinar in the financial community Rankia (see webinar).

To be able to do all this, without neglecting our work analysing of companies, we count on a remarkable team of professionals here at Horos. With our team in mind, I want to give special thanks to some people who have more discrete, but essential roles here at Horos. Without Pepe, Beatriz, Antonio, Juanjo and Rodrigo, this project would not be possible. Thanks goes to all of them for making it possible.

I would also like to thank Carlos Bellas for his years with us. His fulsome dedication and enthusiasm was of enormous value to us all. We wish him the best of luck in his new adventure. He deserves it.

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.

Since its inception on the 21st May until the 30th September, the return of Horos Value Iberia has been 2.3%. In the same period, its benchmark performance was -3.3%. The results obtained in such a short period of time are merely anecdotal and should be considered as such.

At the end of the quarter, **the fund's *theoretical* potential for the next three years was around 40%**, equivalent to an annualised return of 11.9%. On the basis of these figures we believe the fund is presently very attractive

Portfolio Structure

At the end of June, the portfolio of Horos Value Iberia comprised 25 holdings and was concentrated in two important blocks. One block, almost **55%** 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) and with prices that are still attractive in a market that is increasingly difficult to invest in.

The second block **(20%**) is made up of **companies that have been forgotten** or even "hated" by the investment community, because they have historically been unfulfiling for shareholders, but that are very attractive to invest in today.

Horos Value Iberia also invests in **Horos Value Internacional (6.1%**). In this way, the potential of the Iberian fund is increased, increasing the quality of the portfolio and generating greater value for our co-investors in the long-term. Of course, NO commission is charged on that percentage invested in the house funds.

Lastly, the **cash position** of the fund at the end of the quarter stood at 26%. However, the bulk of the time it has been below 20% and hopefully will remain so in the future, given the attractiveness of the new investment ideas for which we are now finalising our analyses.

Main Positions

Renta Corporación (5.1%, forgotten): the company, focussed on acquiring real estate assets for transformation and sale, has gone through a restructuring process, both financial (they have no debt) and business (they use options to purchase the properties to be reformed), which avoids the risks to the balance sheet that are typical of this industry. In addition, it has recently reached an agreement with the Dutch pension fund APG to manage its SOCIMI specialized in residential assets. This SOCIMI has the goal of reaching 1,500 million euros in assets and Renta Corporación, in addition to owning 3% of the SOCIMI, charges a 1.5% fee for its management. 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 restructure its business toward a model of high returns on capital employed.

Ercros (5.0%, forgotten): like Renta Corporación, Ecros is a 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.

OHL (4.7%, forgotten): The sale months ago of its OHL Concessions division to the Australian fund IFM Investors has created a great investment opportunity by changing the company's financial profile and value. The cash position after the transaction is very close to OHL's current market value, giving a high margin of safety. We believe that the doubts about the company's historical capital management are fully justified, but that, at these prices, the potential return on the investment, adjusted for the risk of loss, is very attractive.

Sonae Capital (4.6%, family-owned) 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.

Aperam (4.5%, 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 count on the best investment ideas that this management team finds currently available.

Since its inception on 21 May until 30 September, the return of Horos Value Internacional has been -0.2%. In the same period, its benchmark performance was -1.6%. In the case of Horos Internacional PP, the return has been -0.8%. The difference between the fund and the plan comes from the fact that the plan started its investment process days later, because it did not have sufficient assets to invest. The results obtained in such a short period of time are merely anecdotal and should be considered as such.

At the end of the quarter, **the *theoretical* potential of the international strategy for the next three years was around 90%**, equivalent to an annualised return of 23.9%, and so we think that both products present an enormous attraction at this time.

Portfolio Structure

The portfolio has 33 holdings and four blocks that account for the bulk of it. The principal is comprised of **companies linked to raw materials (23%),** especially stainless steel, petroleum and uranium. Another important block is the one that includes **forgotten emerging stocks (20%)** or stocks scarcely followed by the investment community, mainly from Asia. The investment in **technological platforms (13%)** with a powerful net effect that still trade at very attractive prices for investing and in companies from the **United Kingdom (11%),** impacted by Brexit, would be the other two important investment topics.

Finally, the **liquidity** of the portfolio at the end of the quarter stood at 14%, although we expect to gradually reduce it in the coming weeks to below 10%.

Main Positions

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 upcoming 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.

Asia Standard International (4.6%, 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. Being invested in by other companies traded by the Poon family, in addition to an accounting valuation of the assets at acquisition cost far removed from reality led 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 recurring revenues 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 revenue streams 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.

Qiwi (4.2%, forgotten emergent): One of the most important players in the electronic payment industry in Russia and neighbouring countries, as well as having a strong presence in money transfers and remittances in that market. The business combines its virtual wallet service with the largest network of ATMs in the country for the management and payment of invoices and other payments. The launch more than a year ago of Sovest, its consumer credit card service, requires significant expenses that are helping to dilute the company's margins, hiding the recovery of Qiwi's historic business in recent quarters. In addition, the takeover bid process experienced by the company in 2017, in which the buyer (Otkritie Holding) did not gain sufficient acceptance from shareholders and which, in a turn of events, saw how its subsidiary Otkritie Bank had to be rescued by the Central Bank of Russia, may have contributed to investors' forgetting of value.

Zeal Network (3.9%, others): this is a company specialising in the online lottery business, with the bulk of the business in the German market. Following the 2008 ban on online advertising in that market, Zeal Network converted into a secondary lottery operator in the UK. Since January 2015, the German regulator has insisted the company must pay VAT on the sale of electronically provided services (such as lottery) in Germany, which has placed the valuation of the company at very depressed levels, which more than accounts for the worst possible scenario for the holding.