HORROS

ASSET
MANAGE-
MENT

QUARTERLY LETTER
TO OUR CO-INVESTORS

JULY 2020

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Dear co-investor,

We finished a quarter marked, once again, by the huge impact that covid-19 has had on our lives. A quarter in which we can at least hope that the worst is over. I would like to give everyone who has been affected much encouragement and, of course, thank all of our investors for their trust and patience in this challenging environment.

At the market level, after the sharp falls in February and March, the world's stock markets rebounded strongly, which has contributed to cutting the YTD 2020 losses. Our portfolios have not been immune to this recovery, with Horos Value Internacional posting a 16.0% return in the quarter in line with the 16.5% rise of its benchmark index, and Horos Value Iberia returning 14.1%, above the 8.5% of its benchmark index.

Despite this rise in the NAVs, our funds' upside potential remains close to all-time highs.[1] We are well aware that trusting these potentials implies trusting our way of doing things at Horos. That is why I think it is essential to devote this quarterly letter to a more in-depth look at how we analyse companies. In particular, we will study the role of narratives in our investment theses and the upside potential we obtain for our portfolios.

We continue to strongly believe that these are extraordinary times to invest in our funds. We do not have any crystal ball, nor do we have control over the performance of our portfolios (at least in the short term). But what is clear to us is that, if the work we are doing is correct, these high potentials will eventually turn into healthy and sustainable returns over time.

Yours sincerely,

Javier Ruiz, CFA
Chief Investment Officer
Horos Asset Management

[1] For more detailed information on historical returns and upside potentials, we encourage you to take a look at the appendices included in this document, as well as the information contained on our website.

Executive summary

You can't calm the storm, so stop trying. What you can do is calm yourself. The storm will pass.
— Timber Hakeye

After the sharp market crash in the first quarter of 2020, the world's stock markets have experienced a significant recovery that has helped to mitigate the losses of this challenging year. In this volatile and low-price environment, the Horos team has worked to keep the portfolios' upside potential close to their all-time highs. Obviously, we cannot know when or how these will end up materialising. However, we do believe that **in order for our investors to trust these potentials, they must also trust our work**. This letter therefore explains how we use the concept of narratives in our analysis of companies and how we incorporate it into our valuation. Understanding this part is key to understanding how the upside potential of our funds is formed.

On the other hand, this has been a relatively active quarter for our portfolios. We took advantage of the huge swings in stock prices to rebalance the portfolios, add new stakes and exit holdings with lower upside. Specifically, we added new stakes in companies such as **Atalaya Mining** (a copper mining company with assets in Spain), **Brookfield Property Partners** (a real estate asset manager) and **The One Group Hospitality** (a US high-end hospitality business). We also increased our exposure to the financial sector through the Spanish insurance company **Catalana Occidente** and the UK subprime finance company for used cars **S&U**. Conversely, we exited positions with less upside, such as **DeA Capital** and **Clear Media** (taken over at the end of March), or with a very tight financial position, such as **Borr Drilling** (offshore oil driller in which we held a tiny position).

The compass that guides us

Don't judge each day by the harvest you reap but by the seeds that you plant.
— Robert Louis Stevenson

One of the most important aspects of our analysis, and certainly also one of the most controversial for the public, is the upside potential that we estimate for our funds' holdings. Why is this so important? Because this number condenses ALL the analytical work that Alejandro, Miguel and I have done on a company. Therefore, **the upside potential acts as a compass in all our decisions about how we manage the funds' portfolios**: when to buy, when to sell, when to add a new investment idea into the portfolios or when to discard it and include it in our wish list. Without the upside potential numbers, there would be no portfolio management. It's as simple as that.

It is precisely because this number is so relevant that we decided some time ago to calculate (and publish) the aggregate potential of our funds' portfolios, so that our current and prospective investors could also get an idea of how attractive it may or may not be to invest with us at any given time. However, not understanding what this number contains or what it is based on can lead to conclusions that are very far from reality. For example, one might think that the upside potential of our portfolios is like the dark side (if I may wink at the *Star Wars* movies) of their performance and that, for that very reason, when funds perform badly their upside increases, while when they rise, the latter declines.

However, although this is sometimes the case, it does not always have to be. Throughout our professional careers we have come across situations in which we managed to increase the potential of our funds in bull markets. The reverse is also true: market corrections in which we did not find attractive investment opportunities, because the stocks that declined in price were precisely those we thought were most overvalued or those we had discarded because they did not meet some of our investment criteria (high debt or destructive capital allocation, for example).

It is likely that until the great market correction of 2020—caused by the COVID-19 pandemic that has had such an impact on our lives—we found ourselves in a situation similar to the first one just described, in which equity markets, lifted by the same profile of large and liquid companies, reached high after high, while the rest of the companies (cyclical and less liquid) performed very badly. Against this backdrop, our funds' upside potential gradually increased, while relative performance vs. the stock market indices lagged behind.

However, during this year the correction has been broader and, as we explained in our previous quarterly letter (see here), we have focused our efforts on reducing investment risks, selling those positions with the greatest uncertainty associated with the paralysis of global economic activity and the resulting liquidity shock. At the same time, in recent months we have concentrated the portfolio on those companies that have been excessively punished in this environment and added new ideas. As a result, we have managed to raise the upside potential of our funds to record highs.

Then, would our investors be wise to trust these upside potentials unquestioningly? Obviously, we do not expect an act of faith from them. However, we would like to think that if they invest with us it is because they trust our work and, for this reason, it is so important for them to fully understand that this work is reflected in these numbers and that these also show how attractive it is (or is not) to invest in our funds at any given moment.

In short, understanding some aspects about the calculation of the upside potential of the companies in which we invest, and hence of our funds, can be useful to know how to interpret its meaning and help to make better investment decisions. Therefore, I would like to dedicate the first part of this letter to deal with two of the most important steps in the process of that calculation: **narrative and conviction**.

The story behind the numbers

If you've heard this story before, don't stop me, because I'd like to hear it again.
— Groucho Marx

Every analysis of a company involves a story, usually called a narrative. This story is nothing more than what we believe is going to happen to a company's business, which we try to capture in the assumptions that we incorporate into the valuation process. So, this is about the essence of the analytical work.

One of the authors who has possibly written and researched the most on company valuation is Aswath Damodaran—actually, he is known as the 'Dean of Valuation'. While we do not always fully agree with his approach to value companies, one of his latest books, *Narrative and Numbers*[2], provides an excellent explanation of how to integrate the narrative we have about a business into the valuation of the company.

Specifically, Damodaran discusses five steps that the fundamental analysis of a company must include if we are to arrive at a reasonable valuation. It is worth taking some time to explain each of these steps, so that our work can be better understood. To make this exercise more illustrative, we will draw on examples from some of the companies we have in our portfolio.

Step 1: Develop a story for the business under analysis.

This step covers three others as well. First, we have to do the preliminary work of knowing the **history** of the company. This study is essential for understanding the dynamics of a business, the variables that most affect it and the decisions that the management team has made over the years.

*Example: **Catalana Occidente***

***Catalana Occidente** has two clearly differentiated divisions: traditional insurance and credit insurance. The historical growth of both divisions should be analysed, as well as their profitability (combined ratio and investment returns from the float) in different environments and the company's capital allocation decisions (dividend policy, analysis of the multiple acquisitions of other entities, etc.).*

Second, it is important to understand the **market** in which the company operates and what to expect from it. How fast is the market growing? Are there parts of it growing faster? What investment needs do businesses operating in the sector have? What variables determine their profitability? Is the industry cyclical or non-cyclical? These are some of the (many) questions we should ask ourselves when developing our narrative.

*Example: **Warrior Met Coal***

*First of all, we would have to distinguish in our analysis between the dynamics of metallurgical coal (100% exposure for **Warrior Met Coal**) and thermal coal. The former depends on the evolution of the demand for steel and the needs of the blast furnaces that use this coal in their production process, while the latter is mainly used*

[2] Damodaran, Aswath (2017): *Narrative and Numbers: The Value of Stories in Business*. New York: Columbia University Press.

for electricity generation, which we think is subject to greater future uncertainty (regulation, popular pressure, etc.).

As regards investment needs, in general companies have a relatively low capex. Only in rare cases they can undertake projects to open new mines as long as the sales price support them, as is the case with Blue Creek for ***Warrior****.*

Finally, as with any commodity, the location on the cost curve, transport and labour costs, as well as the sales price, are some of the factors that determine the competitive positioning of each company. ***Warrior*** *has a high-quality metallurgical coal, which allows it to export 100% of its production outside the United States at high prices. It also has a flexible cost structure which helps the company to generate cash flow even in very low-price environments such as the current one.*

And third, we must study the **competitive environment** of the business to understand what we can expect from it today and in coming years. This analysis involves understanding why some companies are more profitable than others in the industry or why some grow more than others, for example.

Example: ***AerCap***

In the aircraft leasing sector, where we have exposure through ***AerCap****, the differences in profitability of some companies and others could be determined, among other things, by the age of the fleet owned by the lessors, the types of aircraft that make up these fleets, the quality of the clients, the aircraft depreciation policy, the cost of financing, the tax rate or the financial leverage (indebtedness) of each company.*

In terms of revenue growth, the size and type of aircraft of the fleet, debt capacity or alternatives to such growth are factors that influence the different growth profiles of each company. Finally, as this is a financial business, the capital allocation decisions of the management team will have a strong impact on the future return of shareholders.

Step 2: Test the narrative to see if it is possible, plausible or probable.

In general terms, we can imagine an endless number of **possible scenarios** for a company, but their probability of occurrence is usually negligible. These types of scenarios tend to have more room in technology companies or with markets to be developed, where "anything can happen".

Example: ***Baidu***

The Chinese company ***Baidu****, of which we have been shareholders for years, has a division dedicated to the development of the autonomous vehicle. We can imagine countless scenarios for this division. For example, that* ***Baidu*** *dominates the Chinese market for autonomous vehicles and exports this technology abroad. But what probability do we assign to dominating the Chinese market and exporting the technology to other countries (the latter being much less likely)? In fact, the likelihood of these scenarios will depend, in turn, on other narratives that we will need to incorporate: will this technology be implemented only in large cities? Will it be limited to the taxi market? Will it impact the sale of new cars?*

Therefore, we are dealing with situations that fall within what in the financial jargon is called 'optionality,' that is to say, unlikely events but of great impact if they end up happening. In our case, we prefer to be conservative and assign a zero value to this division of ***Baidu****, so everything that happens will be an extra return that we do not count on.*

A second group of a smaller number of scenarios, but with a higher likelihood, would be made up of those narratives that we consider **plausible**. These scenarios are not so far-fetched, and their growth and execution risk are easier to value than the case we have just mentioned.

Example: ***Tencent Holdings***

Following the example of the Chinese technology companies we have in our portfolio, we can consider the case of ***Tencent Holdings*** *and its social media advertising division. When we invested in the company (through the South African holding company* ***Naspers****),* ***Tencent*** *only allowed one ad per day to appear on the user portal of its successful social platform Weixin/WeChat. In our opinion, as time went by, it was very likely that* ***Tencent*** *would increase the number of ads, once WeChat users were sufficiently captive (network effect, platform added value, etc.) to be able to make that leap, and also having the close example of what happened in Western companies, such as* ***Facebook****. Therefore, in our valuation, we assumed that the normalized revenue of this division would be much higher than at the time of our investment. Today, WeChat allows four ads per day, which has multiplied the company's monetization possibilities per user.*

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The last group of scenarios would be encompassed by the most **probable** situations that we can incorporate into our valuation. These are, in short, those scenarios that support the cash flow generation base of the business and, therefore, are subject to a smaller (though not insignificant) margin of error.

*Example: **Sonae***

*If we take the Portuguese holding company **Sonae** as an example, the narrative that we incorporated into its food distribution business Sonae MC (mainly, Continente supermarkets) does not contemplate major deviations, which seems most likely given the defensive nature of this business and the few changes that we expect in it. This is very different from the way other divisions of the group, such as Worten or Fashion, may evolve in the coming years, where we can incorporate other additional scenarios that would be within the possible and plausible nature.*

Step 3: Turn the narrative into value drivers.

The third step would consist of translating the narrative into **key business figures**, in order to achieve our calculation of the **business' cash generation**. For example, in determining a company's future sales, we will need to make estimates (explicit and implicit) about the future size of the market in which the business operates, the company's future market share, the number of product units sold or its sales price. Also, based on the study of the sector's dynamics and the company's competitive positioning, we must decide what profitability (operating margins) we can expect from the business in the coming years and what level is the most sustainable (normalized). Other relevant variables could be the tax rate or the working capital requirements of the business, as well as its investment and reinvestment needs.

*Example: **Atalaya Mining***

In the world of commodities there are three fundamental variables in determining the expected level of companies' sales: the volume of the commodity sold, the sales price and, indirectly, the cost of producing that commodity—if the sales price does not cover that cost, the mine will not be able to stay open.

*In the case of the copper mining company **Atalaya Mining**, although it is not one of the best positioned companies in the sector on the production cost curve, we do think that it will be able to generate a lot of cash in the future, given our outlook on the price of copper, **Atalaya**'s low investment needs and its lack of debt.*

Step 4: Connect the value drivers in a valuation estimate.

Once we have translated our narrative into an estimate of the free cash flows the company will generate over the next few years, we need to calculate the **total value of the company**. There are a number of methods for valuing a company. In our case, we generally make three-year estimates and normalize the cash generation of the third year making a few adjustments, among others, to the business margins (up or down), investments (excluding non-recurring ones) or the company's working capital requirements. Finally, we add the last piece of data missing in our narrative: **what multiple does the business deserve to trade at?** Or, to put it another way, what do we think the quality of the business is based on all the previous analysis?

Obviously, we are moving into a very subjective area and, as we have stressed on other occasions, **the whole valuation process is more of an art and less of a science than one might think**. At Horos we may say that the range of exit multiples that we assign to businesses varies between 11x and 18x. Thus, for instance, companies in the commodities sector deserve multiples of around 11x, while Tencent, with its irreplicable and difficult to attack technological ecosystem, would deserve a multiple of around 18x.

With all these ingredients, we can now calculate the upside **potential** of the companies in which we invest, comparing the value we have estimated with their market capitalization. Finally, by weighting the exposure that the portfolios have to each individual position, we would obtain the theoretical upside potential of our investment funds.

Step 5: Keep the feedback loop open.

Our work, as you can imagine (otherwise there would not be five steps), does not end with the calculation of the potential. We need to **constantly monitor our investment and question our thesis on an ongoing basis**. First, because the world is constantly changing, and second, because we may be wrong in our initial analysis. However, before going deeper into this last step, it is necessary to understand why this is so important and, at the same time, so difficult to do.

I want to believe

Looking for extreme possibilities makes you blind to the probable explanation right in front of you.

— Dana Scully (X-Files)

One of the greatest enemies we have when it comes to believing in something or making rational and coherent decisions, is found in our own brain. **Although we like to think that we are rational beings, the reality is that we are excellent rationalisers**. Once we form a belief or make a decision, no matter (to some extent) what evidence is in front of us, we become perfect machines of self-justification. This explains, for example, why the supporters of a political party or an ideology tend to see the devil in every action of the opposing party, unable to look past any of their faults, when much more reprehensible acts of their like-minded party are simply ignored.

Michael Shermer, whose work *The Mind of the Market*[3] we talked about in the previous quarterly letter, has another very interesting book, titled *The Believing Brain*[4]. In this volume, Shermer uses the concept of 'belief-dependent realism' to argue that, as we have just mentioned, beliefs come first and explanations to these beliefs come later. Once we believe in something, the brain looks for (and finds) supporting evidence that reinforces that belief, which gives us more confidence about its accuracy, reinforcing it further and repeating the process as a feedback loop. In a way, we could say that there is an objective reality that is unimportant to our brains, once we have decided to believe in something.

This way our mind works can cause us serious problems, but it also offers us great advantages if we know how to use it to our benefit. Indeed, the knowledge and understanding of **cognitive dissonance**—the technical name for the act of rationalizing/justifying irrational decisions and beliefs—and **confirmation bias**—that tendency to choose only the information that supports our beliefs—can allow us to take advantage in many areas. For example, in his controversial and very interesting book *Win Bigly*[5], Scott Adams explains how Donald Trump took over the presidency of the United States using persuasion techniques that are based on and benefit from these mental traps into which we all fall.

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

[4] Shermer, Michael (2011): *The Believing Brain: From Spiritual Faiths to Political Convictions – How We Construct Beliefs and Reinforce Them as Truths*. US: Times Books.

[5] Adams, Scott (2017): *Win Bigly: Persuasion in a World Where Facts Don't Matter*. New York: Portfolio/Penguin.

In any case, the interesting thing for us as investors is to know that, once we form an idea in our mind, it is very difficult to contradict it and get rid of it. What does all this have to do with our five steps to incorporate narratives into our valuations? Well, it is everything. **Our brain can lead us to imagine a narrative for a company and continuously justify it, relying only on the information that suits us, no matter if reality turns out to be against us**. That is why this fifth step is so important and why we need to have tools that allow us, as far as possible, to objectively contemplate our investment theses and update our narrative and valuation as changes take place.

Step 5: Keep the feedback loop open (cont.).

One of our tasks to keep this feedback loop of the narrative open is precisely to review and update its assumptions. Sometimes, one realizes that his expectations were not realistic and has to make (painful) adjustments to the narrative and the valuation of the company. Therefore, it is very important to be clear, from the very beginning, **what our narrative implies** and whether it is conservative or aggressive.

*Example: **Our investment in uranium***

*As you know, we have been invested in uranium for some time through the financial vehicles Uranium Participation Corporation and Yellow Cake. We will not again describe our investment thesis in this chemical element (see **here**). In our opinion, there are two key variables that will determine the path of the uranium price. On the one hand, the growing uncovered uranium requirements of nuclear reactors in coming years, which will force them to return to enter into long-term supply contracts with the companies that own the uranium mines and deposits. At what price? This is where the second variable comes into play: the supply of uranium. In a number of years, the uranium production cost curve will require prices above $60/70 per pound, so that the mines that will be needed to meet the reactors' needs do not lose money. Given this, we believe that a uranium price slightly above $30 makes no sense and that, at the very least, it should be close to $60 in the medium term. This is our narrative and the passage of time is only reinforcing it*

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There are times when, due to the company profile or the uncertainty associated with the investment thesis, we are not comfortable assuming a particular narrative for the valuation. In those cases, a very valid option is to ask the market directly about its own. What does this mean? Basically, to analyse **what the market discounts** for the company at the price it is trading at.

Example: ***Catalana Occidente***

The Spanish insurance company has two very different divisions: traditional insurance and credit insurance. The former includes, among others, standard car, home, death and life insurance. These businesses are relatively stable in the current environment. However, the latter division, credit insurance, has a very strong cyclical component, as the business consists of insuring companies against potential non-payment of their customers' invoices. In a very challenging situation like the current one, the market fears that this division will suffer and make ***Catalana*** *lose money.*

That said, while it is true that a major impact on this business is to be expected, what exactly is the market discounting? A scenario never seen before, not even in the 2008/2009 crisis, when the company was much less prepared at the risk management and client level for what happened at that time. Specifically, in the lows of €17 that ***Catalana****'s stock price reached in mid-May, the market implicitly assumed that both the credit insurance division and the excess reserves that the company maintains on its balance sheet were worthless and that the traditional insurance division deserved to trade at a conservative multiple of 11x earnings. Of course, we can debate about what will happen to the credit insurance business or how much the excess reserves are worth, but what we think it just does not make sense is that they are worth zero. This simple exercise reinforced our investment thesis for the company at a time of high uncertainty about its future.*

> *Markets tend to overdiscount the uncertainty related to identified risks. Conversely, markets tend to underdiscount risks that have not yet been expressly identified.*[6]

Obviously, another very relevant way of making our narratives more robust is to have a **solid investment process**, including steps that contribute to achieving this goal. In this sense, as I'm sure you have heard us say before, one of the advantages of being a truly management team at Horos is that we always need a consensus of the three of us to be able to invest in a company. Specifically, one of the portfolio

[6] Quote by Jamie Mai, investor known for his appearance in the book *The Big Short* by Michael Lewis, taken from Schwager, Jack D. (2012): *Hedge Fund Market Wizards: How Winning Traders Win*. Hoboken, New Jersey: John Wiley & Sons.

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managers conducts the initial analysis of a company and the rest of the team tries to kill the investment thesis. This forces us to continually rethink the narrative that we are assuming, thus reinforcing its consistency and only allowing those ideas that overcome this tough filter to enter our portfolio.

On other occasions, the market gives us the opportunity to sort of skip the narrative, avoiding the risk associated with having to make estimates about the future of the company. These situations arise when we invest in companies that offer **free options** at the prices at which they trade. This would be the case discussed above of **Baidu** and its autonomous vehicle technology. Other examples, also commented on in previous letters and presentations, could be **Keck Seng Investments** (see here) and the hotel and real estate assets that we take for "free" at current prices or that of **Meliá Hotels International**, whose conservative valuation of hotel assets comfortably supports the current stock price and allows us to obtain the free option on the hotel management business..

However, what we have written so far in this letter would be useless if the portfolio managers do not have the right attitude to carry it out. In the end, we need to be aware that **our ego is our main enemy**. [7] We need to be humble enough to assume that we are going to make mistakes and, what is sometimes more difficult, learn to detect errors early and adjust our investment thesis to the new reality we are contemplating, trying to avoid getting stuck in that dangerous loop of belief and confirmation. Therefore, **at Horos we work with the premise that our knowledge is limited, but always maintaining a limitless thirst for constant learning**.

It is impossible for a man to learn what he thinks he already knows. [8]

Main changes to our portfolio

It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change.
— Comment attributed to Charles Darwin

The following is a summary of the most significant changes to our funds' portfolios:

[7] To learn more about this topic, I recommend Holiday, Ryan (2016): *Ego is the Enemy: The Fight to Master Our Greatest Opponent*. London: Profile Books.
[8] Epicteto's quote taken from Holiday, Ryan (2016).

HOROS VALUE INTERNACIONAL
Stake decreases & exits:

LNG AND CRUDE OIL INFRASTRUCTURE AND SHIPPING
Exposure trimmed from 10.9% to 8.4%
Holdings: Teekay Corp. (4.5%), Golar LNG (2.2%) and Teekay LNG (1.7%)

We trimmed our exposure to the two Teekay companies after the strong rally they experienced in April from the March lows (**Teekay Corp.** rallied 120% while **Teekay LNG** 70%). In the case of **Teekay LNG**, the share price has been relatively flat since then, while the holding company **Teekay Corp.** has had a sharp decline and returned to its lows. What justifies this poor performance of the company on the stock market?

On the one hand, **Teekay Corp.** and **Teekay LNG** finally announced the expected transaction of the Incentive Distribution Rights (IDRs) that **Teekay Corp.** held over **Teekay LNG**. Specifically, **Teekay LNG** acquired the IDRs by issuing 10.75 million shares (around $120 million at the time of the transaction). As a reminder of the functioning of the IDRs, **Teekay Corp.** was entitled to receive an extraordinary dividend from **Teekay LNG**, provided that the latter exceeded certain minimum thresholds for earnings distributions to its shareholders. In addition, as we have mentioned in the past, **Teekay Corp.** controlled c.34% of **Teekay LNG** (31.7% via common shares and 2.0% via a General Partner agreement). In our opinion, this complex capital structure made it difficult to value both companies, so the transaction announced on May 11 looks positive to us. However, the terms of this transaction were somewhat disappointing from the perspective of **Teekay Corp.**'s shareholders—who now control 42.5% of **Teekay LNG**—so we adjusted our valuation of **Teekay Corp.** downwards.

On the other hand, **Teekay Corp.** owns about 29% of **Teekay Tankers**, a tanker company. The latter's share price has been a truly roller coaster so far in 2020. Just as an example, **Teekay Tankers**' stock price fell by 50% from the beginning of the year to the lows reached in February. Then, it recovered all the losses (a 100% rise) on the back of the increase in tankers' freight rates, caused by the strong demand for oil floating storage and the resulting decline in the supply of tankers for transportation. The company has taken the opportunity to significantly reduce its debt with the large increase in cash generation from the business in the period, and to sign contracts at fixed rates for some of its ships. Despite this, after the easing of demand for oil floating storage and the fall in freight rates, the price has returned to 52-week lows, thus giving back previous gains and having a negative impact on **Teekay Corp.**'s stock price.

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As for our own perspective, we maintain the thesis that the market is not correctly valuing **Teekay Corp.** and we think that the measures that the management team has been taking in the last few months—reducing debt, improving the situation of the Floating Production Storage and Offloading vessels (FPSOs) and simplifying the capital structure—will contribute to the materialization of the investment thesis.

URANIUM

Exposure trimmed from 8.8% to 7.2%
Holdings: Yellow Cake (3.7%) and Uranium Participation (3.5%)

In the previous quarterly letter, we highlighted the great impact that the covid-19 pandemic is having on the supply of uranium, with a reduction of more than 50% due to the forced closures of the main mines in the sector. This shock has led to a 21% increase in uranium prices in the quarter—and 33% year-to-date.

Obviously, our investments in **Yellow Cake** and **Uranium Participation** (financial vehicles that buy physical uranium for storage) have benefited from this supply tightening, although less than expected. **Yellow Cake** was up 11% in the quarter and **Uranium Participation** gained 17% in the period. This performance, together with the poor relative performance of both vehicles in the previous quarter, led to a discount on the value of their assets of over 20%. In other words, buying shares of **Yellow Cake** and **Uranium Participation** was equivalent to acquiring uranium at a discount of more than 20% on its market price.

The management teams of both companies are aware of the opportunity to create value and have been buying back their own shares for weeks. In fact, at the end of the quarter **Yellow Cake** announced the sale of 300,000 pounds of uranium to use the proceeds (c.$10 million) to buy back shares of the company, i.e. uranium at a discount. We are convinced that these measures will contribute to the closing of this inefficiency.

The fund's weight reduction in this investment theme, which remains the largest individual position (combining the two vehicles stands at 7.2%), is exclusively due to the rise of new investment opportunities that we will discuss below.

OTHER

5.1% of the portfolio
Exited holdings: Clear Media, DeA Capital and Borr Drilling

As we pointed out in our previous letter, on 31 March **Clear Media** received a takeover bid from a consortium of investors led by the company's own management team. We accepted the takeover offer in April, selling our shares with significant gains.

With regard to **Borr Drilling**, we sold the tiny remaining position (0.1%) we held in the offshore drilling company, given its worsening financial situation. After exiting **Valaris** in the previous quarter, now our only stake in this sector—whose fundamentals have deteriorated dramatically in recent months—is **Shelf Drilling** (0.4%). Although we are convinced that some of the companies in this industry will eventually be multi-baggers, we are not willing to take the risks associated with the current environment.

Finally, we sold the Italian holding company **DeA Capital** after its strong performance and relatively low upside potential compared with the other alternatives in the portfolio.

Stake increases & new stakes:

FINANCIALS

6.6% of the portfolio

New stakes: Catalana Occidente (5.2%) and S&U (1.4%)

When investing in the financial sector, we always try to do so through those companies that have a management team with excellent capital allocation skills and track record. The reason is very simple. Financial companies tend to operate with high financial leverage (debt). In good times, when any decision seems right, this leverage multiplies the profitability of the business. However, when the economy takes a hit, if growth or risk-taking decisions were not conservative, leverage has the same effect but in the opposite direction, thus magnifying the losses. Moreover, in such recessionary environments, if capital allocation or operating decisions were aggressive, the value of assets (e.g. loans) declines, putting the solvency of these entities at risk. Hence, the banking sector has to be bailed out or raise massive amounts of capital in every crisis. Obviously, we are confident that **Catalana Occidente** and **S&U** have excellent management teams, the reason why we invested in both companies.

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Catalana Occidente ("**Catalana**")[9], a Spanish insurance company in which we have been shareholders for years in our Iberian portfolio, was added to the international portfolio due to its very attractive risk-return profile at current prices. The insurance company has two lines of business: traditional insurance (car, home, health, life...) and credit insurance. It is precisely the latter that concerns the investment community today and that is greatly affecting the company's share price. **Catalana** insures companies by issuing credit insurance against potential non-payment by their customers. In an environment such as the present one, there is a justified fear of a rise in the number of claims filed, which would lead to significant outlays for **Catalana**.

However, after analysing what the market was discounting at the time of our investment, we concluded that the company's market capitalisation implicitly valued the traditional business' earnings at a conservative multiple of 11x—when it should be higher due to its excellent management and profitability—while giving zero value to the excess reserves that **Catalana** accumulated on its balance sheet—which could be distributed as a dividend at any time—as well as zero value *in perpetuity* for the credit insurance business.

We understand the market's short-term fears, but on the one hand, despite its cyclical nature, credit insurance has proven to be the most profitable division of **Catalana**'s business because of the dynamics of an oligopolistic industry. On the other hand, the company has implemented continuous improvements in this division's risk management, such as requiring an excess payment from the insured in the event of a claim or selecting customers with less risk than in the pre-crisis period, when the former Atradius had not yet been acquired by **Catalana**. In addition, some countries, such as Germany, have approved significant aid packages for the sector, under which states will assume this year's losses, in exchange for these entities not making any profit in the year.

This set of factors, together with the company's outstanding capital allocation track record due to a long-term business vision and a total alignment of interests with shareholders (the Serra family controls about 61% of the shares), as well as a depressed valuation (2022 P/E below 4x and 2022 P/BV of 0.5x), led us to position **Catalana Occidente** as one of the fund's top holdings.

Meanwhile, **S&U** is a third-generation family business (its chairman, Anthony Coombs, is the grandson of the founder) focused on giving loans to subprime customers, usually rejected by banks because of their poor financial profile, for the

[9] If you have read the section on narratives above, you can skip the next paragraphs summarising our investment thesis in Catalana Occidente, although here we go into more detail.

purchase of second-hand cars (Advantage Finance division) and providing short-term or bridge financing to developers for the acquisition, refurbishment and subsequent sale of quality property (Aspen Bridging division).

Despite the company's conservative approach to growth (subprime clients do not necessarily mean accepting just any client) and debt (leverage ratios are far below those of other banks), **S&U** has achieved double-digit returns on equity averaging 16% since 2010 owing to the high margins of its business of over 30%.

Although this year the company will not be immune to the impact of the economic paralysis in the UK, its financial strength, excellent capital allocation and the growth opportunities that will arise in this crisis, allowed us to take a position at a historically low valuation point of 0.8x 2022 P/BV.

RESTAURANT BUSINESS

2.3% of the portfolio
New stakes: The ONE Group Hospitality (2.0%) and Tang Palace China Holding (0.3%)

As you can imagine, the restaurant business has been one of the hardest hit during the current economic crisis. However, such uncertain environments in which all companies are equally punished tend to provide interesting investment opportunities, always with a longer-term view. We think that this is the case of **The ONE Group Hospitality** and **Tang Palace China Holding**.

The ONE Group Hospitality ("**ONE**") controls, develops, manages and franchises high-end restaurants in the United States. In addition, the company provides turnkey food and beverage solutions to luxury hotels, casinos and other premium locations. Specifically, **ONE** has three lines of business: STK ("Steakhouse") restaurants, Kona Grill restaurants and ONE Hospitality Services.

As a result of poor business management, **ONE**'s stock market performance remained poor from its IPO in 2013 until 2017, when the company's CEO changed, with Emanuel "Manny" Hilario joining the company and Jonathan Segal, co-founder of **ONE** and owner of 25% of the shares, becoming Chairman. Manny Hilario brings his extensive experience in managing restaurant companies and, since his arrival, has taken important steps to improve the management and profitability of the business: closing less profitable restaurants, acquiring Kona Grill at very attractive prices or strengthening the licensing model, which is less capital intensive.

All these changes allowed the company to recover the path of like-for-like sales growth and generate positive cash flow, which resulted in a strong rise in the stock price of more than 230% from the end of 2017 until February this year, when the coronavirus pandemic has had the consequences we all know and has led **ONE**'s shares to all-time lows.

In our opinion, despite the fact that the next few months are highly uncertain, the company has the financial capacity to withstand this environment and has laid the foundations for solid revenue growth and cash generation for the coming years. This longer-term vision allowed us to invest in **ONE** at extremely attractive prices.

Tang Palace China Holdings ("**Tang Palace**") is a company that owns restaurants and food production and service businesses in China. Tang Palace operates under both its own brands and those of third parties through joint ventures. Since its IPO in 2011, the company has grown from 27 restaurants to 73 (including the third-party ones), doubling its revenues, maintaining its profitability levels and always managing growth prudently.

Tang Palace is a family business in which the founders control 66% of the capital, which aligns the interests of the management team with the rest of the shareholders. The company has a solid financial position. However, its cash represents more than 50% of the company's market capitalization. While this is usually one of the negatives attributed to this type of investment (why don't they distribute that cash if they are not investing it in the business?), in the case of **Tang Palace** we are talking about a company that generously rewards its shareholders, with a dividend yield of over 10% in 2018 and 2019 and that has distributed all the cash generated since 2017. If we add to this its attractive valuation after declining by 40% so far in 2020, it becomes clear why we initiated a stake in the company.

OTHER

3.9% of the portfolio
New stakes: Brookfield Property Partners (3.0%) and Groupe Guillin (0.9%)

The Canadian company **Brookfield Property Partners** ("**BPY**") is one of the largest real estate asset managers in the world. It owns, operates and develops a large portfolio of office, retail, multi-family, industrial, hospitality and student housing properties, among others. The company has seen a significant stock price decline this year of about 65%, caused—as it cannot be otherwise—by the great impact of the coronavirus pandemic on the occupation and use of its assets. To this we must add the market's structural fear regarding **BPY**'s high exposure to shopping

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centres, where bankruptcies and closures have occurred in recent years due to changes in the population's consumption patterns given the rise of e-commerce.

Despite this, we think that **BPY** provides an interesting window of opportunity to invest at this time. The reasons? On the one hand, the company's portfolio of shopping centres is of high quality and has been acquired at very attractive prices (see, for example, the acquisition of General Growth Properties). On the other hand, **BPY** is controlled—51% of the capital—by Brookfield Asset Management, one of the world's largest alternative asset managers and possibly one of the best teams allocating the capital of its companies. In the case of **BPY**, this translates into value-creating acquisitions, high dividend payments and share buybacks with a high discount on Net Asset Value (NAV). As an example of this, on July 2 **BPY** announced the offer to buy back its own shares for about 8% of the company's capital.

In short, investing in **BPY** means buying a global and diversified portfolio of assets with a high discount on its NAV (of 70% at the stock price lows) and partnering with outstanding capital allocators, who will take the necessary measures to reduce this discount and unlock the real value of these assets.

As for **Groupe Guillin**, it is a French company of which the Horos management team was a shareholder in the past. The company is the leading European manufacturer of thermoformed plastics for the food industry. It is a family-owned business, where the Guillin family controls 65% of the shares, with a capital allocation strategy focused on prudent inorganic growth (always keeping debt under control) that has resulted in a historical annualised sales growth of 7% (4% organic).

Groupe Guillin sells 94% of its products in Europe and has 16 production centres that allow it to be very close to its customers, which is essential to offer a competitive product in terms of price. Since 2017, the company's stock price has experienced a c.75% drawdown caused by two reasons. First, the uncertainty associated with Brexit and its impact on the UK economy and its currency (19% of the group's revenues). Second, possibly more importantly, the uncertainty about the future regulation of the use of plastic and its impact on **Groupe Guillin**'s business.

With regard to Brexit, we believe that its effect and associated uncertainty will fade in the long term. As for regulatory risk, it has never been easy to play guessing games with the decisions of regulators, given the infinite interests that usually accompany them. However, the new regulations that are being issued seem to indicate that the impact will be less than estimated for the sector and, furthermore, the company has been taking steps to adapt its product mix to potential future changes and has also introduced new products made from pulp or cardboard.

Although the risks are real and difficult to quantify, the current valuation provides us with a significant margin of safety that should protect us from very negative scenarios, which, together with having a top-notch management team, led us to invest again in **Groupe Guillin** after several years out.

HOROS VALUE IBERIA

Stake decreases & exits:

OTHER
From 17.6% to 12.9% of the portfolio
Stakes decreased: Meliá Hotels International (5.9% current weight), Sonae (3.6%) and Ercros (3.4%)

In all three cases, we took advantage of the strong rally in April to somewhat trim our stakes in these companies. However, we must emphasise that we have cut our estimates of the three companies' valuation, due to a (slight) deterioration of the investment thesis derived from the coronavirus pandemic and its economic impact.

That said, all three stocks continue to show high upside potential and maintain a financial position that should protect them against this challenging environment. This is why they remain among the top holdings in our portfolio.

Stake increases & new stakes:

COMMODITIES
2.6% of the portfolio
New stake: Atalaya Mining

Our Horos Value Iberia fund can invest, as stated in the prospectus, up to 10% of its portfolio in companies listed on non-Iberian stock exchanges, provided that their business operates in Spain. Such is the case of **Atalaya Mining** ("**Atalaya**"), the copper mining company and owner of the Riotinto project in Huelva.

The Riotinto project is a historic mine (actually, its deposits have been exploited since before the Roman Empire) that has changed hands over time, until it was put into care and maintenance in 2001. **Atalaya** took over this asset between 2007 and 2008, restarting its exploitation in 2016 and making successive investments and expansions in the following years. At the competitive positioning level, this is a project that stands within the 66% most efficient of the production cost curve in the sector. This, together with low future investment needs and our positive expectations for the price of copper, will enable Riotinto to generate significant amounts of cash.

On the other hand, in February 2017 **Atalaya** exercised the option to take over 80% of the Touro project, located in Galicia and inactive since the 1970s. Although the company has always been optimistic about the start-up of Touro, at the beginning of this year the Galician Government raised concerns about the potential "environmental damage" of the project. For this reason, we prefer to be conservative and not take the project into account in our valuation.

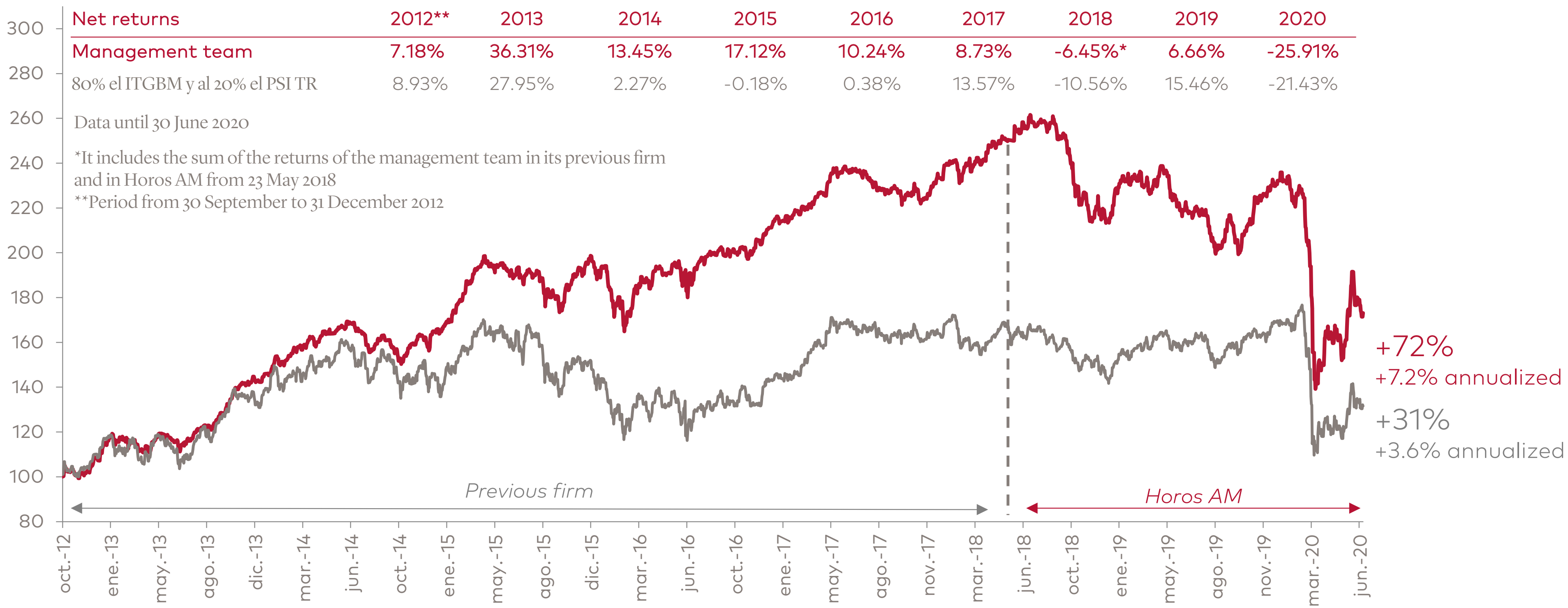
Finally, **Atalaya** has a first-class management team, an aligned shareholder base, a very solid financial position and good prospects for the Riotinto project that have not been reflected in the stock price. Hence, we decided to start building a position in the company.

Annex

Returns

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

Net returns	2012**	2013	2014	2015	2016	2017	2018	2019	2020
Management team	7.18%	36.31%	13.45%	17.12%	10.24%	8.73%	-6.45%*	6.66%	-25.91%
80% el ITGBM y al 20% el PSI TR	8.93%	27.95%	2.27%	-0.18%	0.38%	13.57%	-10.56%	15.46%	-21.43%



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

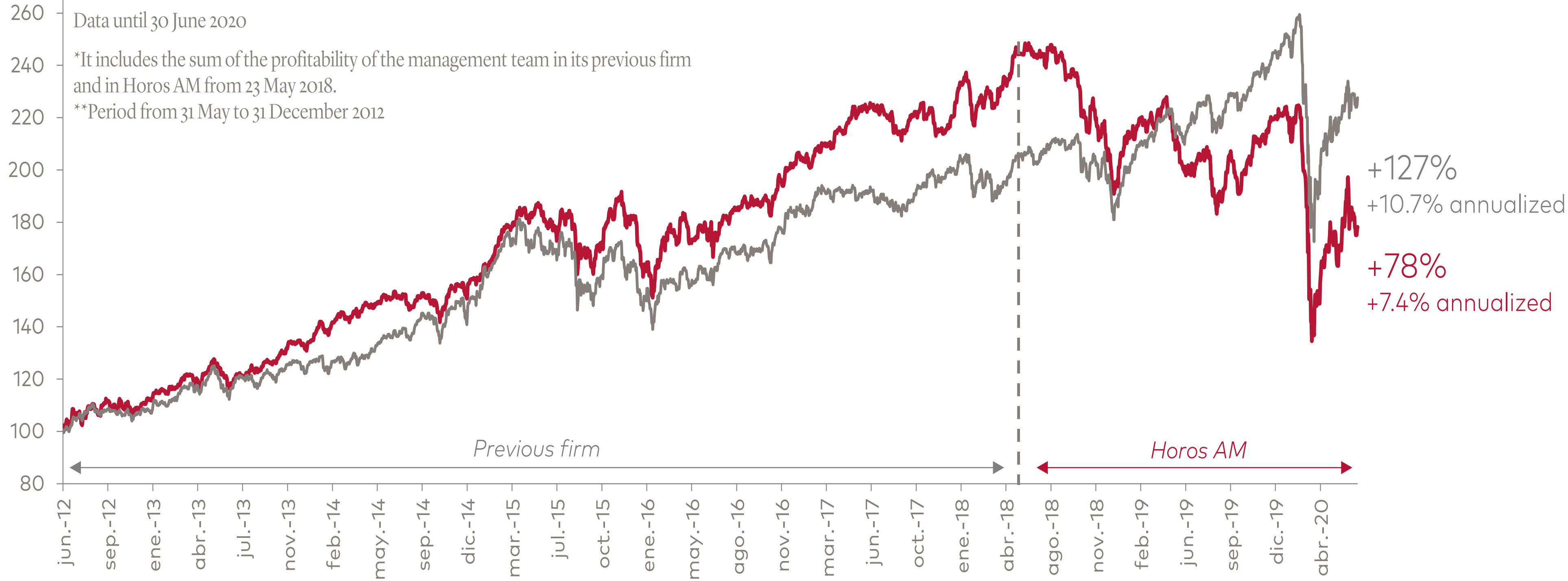
Returns

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

Net returns	2012**	2013	2014	2015	2016	2017	2018	2019	2020
Management team	13.90%	19.90%	17.60%	14.90%	11.00%	11.60%	-13.72%*	12.89%	-19.02%
MSCI ACWI Net Total Return EUR	8.17%	17.49%	18.61%	8.76%	11.09%	8.89%	-5.05%	28.92%	-6.30%

Data until 30 June 2020

*It includes the sum of the profitability of the management team in its previous firm and in Horos AM from 23 May 2018.
**Period from 31 May to 31 December 2012



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Upside potential

Historical potential of the management team

Data from 31 March 2014 to 30 June 2020

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