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QUARTERLY LETTER TO OUR CO-INVESTORS

JANUARY 2021

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Dear co-investor,

Finally, a very difficult year for everyone has come to an end. I can add little to the encouragement and gratitude for your trust that we have shown you in our previous letters. May the arrival of the vaccine be the turning point we all wish for our lives.

Indeed, that turning point seems to have already come to the financial markets, with equity indexes experiencing a strong recovery in the last months of the year. This time it was the most cyclical and smaller, less liquid companies that outperformed. Thus, Horos Value Internacional returned 26.3% in the quarter, compared to 11.9% in its benchmark index. On the other hand, Horos Value Iberia posted a return of 27.9%, outperforming the 22.8% rise of its benchmark.

However, we continue to believe that the companies we own in our portfolio, mostly cyclical and smaller companies, have a high upside potential. As you know, our exposure to the commodities sector is a significant feature of our funds. It is therefore very important that you understand how we analyze this industry and select the companies in which we invest. This is what we will be devoting the bulk of this last letter of 2020 to, including an account of our investment mistake in offshore drilling companies. As we always say, in order to improve our investment process, we must detect the mistakes we make and learn what decisions/reasons led us to make them, in order to reduce the chances of these situations occurring again.

My best wishes for 2021.

Yours sincerely,

Javier Ruiz, CFA
Chief Investment Officer
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Executive summary

Cycles will never stop occurring.
— Howard Marks

The arrival of the COVID-19 vaccines may be marking a turning point in our lives and in financial markets, which have already begun to price in an expected economic recovery. In this new environment of less uncertainty, the stock performance of the hardest-hit sectors and investment themes over the last two and a half years has been outstanding. These are companies with more cyclical businesses and those with a smaller size and liquidity. Our funds have not been immune to this recovery, as they have strong exposure to these companies, which have been so badly affected by the dynamics we have mentioned in previous letters. However, we still see a very high upside potential in our portfolios, where we can highlight our exposure to the commodities sector. For this reason, we dedicate the current letter to explain our analysis of this industry, through tools such as the capital cycle analysis or the Austrian Business Cycle Theory, as well as to comment on some of our historical and current holdings in this area, so loved and hated by the investment community.

Additionally, we will discuss the most significant changes to our portfolios. Among others, we can highlight that in Horos Value Internacional we exited our position in **Qiwi**, after the regulatory uncertainty in its business increased, as well as **KKR**, due to its good performance. On the other hand, we initiated two new positions in the quarter. Specifically, we invested in the podcast hosting company **Liberated Syndication**, as well as in **GAMCO Investors,** the historic asset manager with an excellent track record in value investing. In Horos Value Iberia, we sold **Sonae Capital**, following the improvement of the takeover bid launched by the Azevedo family, and added **Ence**, after the announcement of the sale of 49% of its energy division, unveiling significant value in the company, while at the same time reducing its debt.

The history that always repeats itself

Look back over the past with its changing empires that rose and fell, and you can foresee the future too.
— Marco Aurelio

The team that Alejandro, Miguel and I form, have had—as the co-investors who have been with us a long time know—a generalist profile when it comes to approaching investment. By this I mean our willingness to invest in any sector or geography, as long as the company meets the requirements we require to be added to our funds. Thus, throughout our professional career, our portfolios have included stocks belonging to sectors as diverse as technology, real estate, finance, retail and commodities, as far away as Japan (when nobody wanted to know anything about its stock market, back in 2012), the United States, Hong Kong, Russia and even Colombia.

In order to be able to cover this vast investment universe, it is vital to have tools or mental models that help us understand how markets work and identify potentially exploitable inefficiencies. In the first quarter of 2020 (see **here**), we talked about the most relevant mental models that the Horos team uses. In particular, we relied on complex adaptive systems to understand the mechanisms behind the market excesses, as well as the sharp market decline (and subsequent recovery), as a result of the uncertainty associated with the Covid-19 pandemic and its impact on the world's economies. On this occasion, I would like to delve into another mental model, which is essential to our work and will help you understand our significant exposure to the commodities sector of the last few years: **the capital cycle analysis**.

The capital cycle analysis is the conceptual framework that can serve as a guide in our study of industries with businesses and products, in general, little differentiated and therefore more likely to suffer major cycles. Hence, it is a very useful tool for investing in commodity-related companies. This analysis, popularized in recent years by Marathon Asset Management in the wonderful (the best?) investment book *Capital Returns*, focuses particularly on the study of the **supply behavior** of each sector, as this is the predominant force in the different phases of the capital cycle.[1]

[1] Chancellor, Edward (editor) and Marathon Asset Management (2016): *Capital Returns: Investing Through the Capital Cycle. A Money Manager's Reports: 2002-15*. Palgrave Macmillan.

Capital cycle analysis, however, focuses on supply rather than demand. Supply prospects are far less uncertain than demand, and thus easier to forecast.[2]

To better understand this, let's look at the four phases that make up these capital cycles in the commodities sector:

- **Boom**: the market environment is positive for the industry's producers (supply), as there is an unsatisfied demand in the market, which causes a rise in the commodity prices and a return on the invested capital of the producers that is higher than its cost. The boom phase usually coincides with significant stock market gains of the companies in the sector.

- **Investor optimism**: the prospect of large returns attracts new capital, increasing the current supply, by exploiting areas with higher extraction costs (in the case of mining, for example, producing the lower grade deposits, now profitable), and increasing the future supply, by developing new projects that will come into production years later. The industry's discipline is lost. In this phase, companies usually trade at very demanding valuations, discounting all the good and very little of the bad to come.

- **Depression**: optimism and lack of discipline lead to an excess of supply (and competition), usually exacerbated by demand that is weaker than initially expected. This imbalance triggers a collapse in commodity prices and returns on capital fall below its cost. The depressed phase is accompanied by sharp declines in the stock market value of companies in the sector, as it cannot be otherwise.

- **Investor pessimism**: low returns lead to a drastic reduction in investment in current supply (closure of less efficient deposits/mines) and future supply (no money whatsoever allocated to the exploration and development of new projects), as well as sector consolidation. Unlike in the phase of investor optimism, in this stage the companies trade at depressed valuations, discounting all the bad (permanently low commodity price scenarios, with consequently value-destroying capital returns) and none of the good (capital discipline sows the seed of future recovery). The lack of supply-side investment tends to drag on to the point of triggering an imbalance that supports supply, starting the cycle with its boom phase again.

[2] *Idem.*

Therefore, we clearly see the power of supply in the formation of these cycles and how vital it is to know what phase the sector is in, to try to take advantage of the periods of investor pessimism and boom in the cycle.

Note, additionally, the relevance of other mental models that can help us to complement the above analysis, belonging to the field of **behavioral economics**. *Overconfidence* (especially when forecasting prices or project development times), *optimism* (fueling the overconfidence just mentioned), *anchoring bias* (extrapolating the current market situation into the future, without analyzing the expected supply and demand dynamics), *cognitive dissonance* leading to the rationalization of irrational beliefs (prices will not fall) in the face of contrary evidence (increased competition and excess supply in the future) or *inside view* (thinking, for example, that my mining project will see the light of day in 5 years, when the history of other projects in the industry says that the average time is 8 years), among many others, can help us understand and anticipate the irrationality that most company executives in these sectors, as well as investors, continually incur in injecting capital at the worst times—when everything is going well and can only get worse—and draining it at the best times—when everything is going badly and can only get better.[3]

> *High profitability loosens capital discipline in an industry. When returns are high, companies are inclined to boost capital spending.*[4]

However, although the capital cycle analysis that we have described, supported by behavioral economics, is very helpful in navigating with certain guarantees of success the ups and downs of cyclical industries, we have another—more global—theoretical framework for understanding the formation of capital cycles, both at the industry and macro level: **the Austrian Business Cycle Theory**.

An approach to the Austrian Business Cycle Theory

There is nothing more practical than a good theory.
— Jesús Huerta de Soto

I am aware that this section may be difficult for the reader to follow, although I have tried to simplify the underlying idea as much as possible. If you prefer, you can jump

[3] To go deeper into the biases and heuristics described by behavioral economics, I recommend reading Kahneman, Daniel (2012): *Thinking, Fast and Slow*. Farrar, Straus and Giroux.
[4] Chancellor, Edward (*ibidem*).

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to the next section, "The commodity supercycle", where we apply the theory exposed here.

The Austrian Business Cycle Theory ("ABCT", from now on) is possibly one of the most interesting models developed by the **Austrian School of Economics**. Some economists point to the scholastics of the School of Salamanca in the 16th century (Francisco de Vitoria, Martín de Azpilicueta, Diego de Covarrubias or Luis de Molina) as the origin or precursors of this school of economics.[5] However, its foundation, as such, dates back to 1871, with the publication of Carl Menger's *Principles of Political Economy*. Later, during the last century, economists such as Ludwig von Mises, Friedrich von Hayek or Murray Rothbard, made the school more notorious. In Spain, we also have great scholars who belong to or are related to the Austrian School, two of whom stand: Jesús Huerta de Soto and Juan Ramón Rallo. Precisely, these two economists have written two essential books to better understand the ABCT: *Money, Bank Credit, and Economic Cycles* (by Jesús Huerta de Soto) and *A Critique of Mises' Monetary Theory* (by Juan Ramón Rallo).[6]

It is not the purpose of this letter to go into detail on the work (and differences) of these authors, nor to write twenty pages developing the ABCT. However, it is necessary to understand its essence in order to put it into practice in our subsequent analysis of the commodities sector. Basically, the ABCT states that cycles are **aggregate miscoordinations between the consumption plans of savers and the production plans of investors or entrepreneurs**.[7] Why do these miscoordinations occur? Because of the widespread liquidity degradation of economic agents, through the indiscriminate abuse of the **maturity and risk mismatch**. In other words, borrowing through short-term financing to invest in long-term maturity assets. This lack of coordination and liquidity degradation is magnified through the **banking system**, which acts as a financial intermediary facilitating this mismatch.

Why does the banking sector operate in this way? Basically, for three reasons. First, because it is very profitable to **arbitrage the interest rate curve**, taking on short-term debt (for example, by creating demand deposits or borrowing from other financial institutions) in order to invest in the long term (usually by granting loans

[5] Jesús Huerta de Soto: "New Light on the Prehistory of the Theory of Banking and the School of Salamanca", *The Review of Austrian Economics*, vol. 9, nº2, 1996, pp. 59-81.
[6] The original title in Spanish is *Una Crítica a la Teoría Monetaria de Mises*, which has not been translated into English as of yet.
[7] In fact, I rely, in part, on the version of the ABCT updated by Juan Ramón Rallo with the fundamentals of the liquidity theorists and summarized in his talk "La Teoría de la Liquidez" (The Liquidity Theory) that he gave at the XI Austrian Economic Congress (26/27 September 2018). The talk is available on the YouTube channel of the Juan de Mariana Institute. Of course, all the inaccuracies and errors that this letter may contain are my responsibility.

to individuals and companies that mature in the distant future), due to the term spread that normally exists (the longer the term, the higher the interest rate) to compensate for the risks associated with longer maturities. Second, because, although banks take an excessive and unsustainable risk with this approach, they can always count on the lender (and buyer) of last resort: the **central bank**. Third, because the central bank itself, through its monetary policy, encourages banks to engage in this maturity mismatch.

An illustrative example of the maturity mismatch is the following:

To help understand the role of the bank as a financial intermediary (and oversimplifying), let's imagine that an average citizen, named Julian, wants to lend ten thousand euros to his brother-in-law so that he can buy some machinery he needs for his new business. His brother-in-law promises him that in two years he will pay him back those ten thousand euros, plus an additional four hundred euros as interest for the time spent and the risk incurred. If Julian had that money in savings, he could decide not to use it for two years and lend it to his brother-in-law, so there would be a ***temporal coordination*** *between his savings/consumption plan and his investment plan (two years). However, Julian does not have that money available or prefers to spend it, so he turns to his mother to lend him those ten thousand euros, charging him two hundred euros in interest at the end of those two years. Julian lends this money to his brother-in-law and, if everything goes as expected, at the end of the second year he will have pocketed two hundred euros for his role as* ***financial intermediary*** *(ten thousand four hundred that his brother-in-law will return to him, minus ten thousand two hundred that he will give to his mother).*

So far there is no maturity mismatch and the risk comes from his brother-in-law not paying back in due time and at the right conditions. Let's now imagine that Julian's mother tells him that she will lend him the money, but that she may need it in three months to buy a car. In that case, if Julian goes ahead with the financial transaction, he begins to take a clear ***liquidity*** *(and solvency)* ***risk*** *because his mother may demand the money before he gets it back. If so, Julian will need someone to lend him ten thousand euros (plus interest) within three months, in order to be able to pay his mother back.*

Well, this is exactly what banks do, but with much greater mismatch and liquidity risks, always taking for granted that they will be able to refinance their debt—thanks to the fact that, ultimately, they can be rescued by the central bank. This would mean that Julian could, as a last resort, always turn to his father if he could not get anyone to refinance him, to repay the debt to his mother if she needed the money before he could get back what he had lent to his brother-in-law.

This persistent mismatch carried out by the banking sector—and other very important economic agents, such as the so-called "shadow banking"—leads to the classic **flattening of the yield curve**, encouraging agents to take on more debt in order to develop longer-term and, therefore, more illiquid investment projects (let's imagine that Julian's brother-in-law takes advantage of this decline in long-term rates to ask him for money for another, now more attractive, ten-year project) and consequently discouraging long-term savings. However, and this is the key, there has been no coordination between the plans of savers and those of entrepreneurs. Savers are providing short-term funds because they want to consume in the short term (remember Julian's mother and the car). Entrepreneurs (Julian's brother-in-law), however, find long-term financing through the banking system (Julian), as if such coordination did exist (ten-year business project). This lack of coordination can go on for some time, increasing the risks taken by the banking sector, making it more **fragile and unstable** as well as generating competition bidding up for the resources of economic agents, which often leads to **inflation** and, on occasion, asset **bubbles**.

How do we get to inflation? On the one hand, entrepreneurs are focused on new long-term plans that are further away from the end product (projects that take years to complete, such as developing new machinery, a capital good, for the more efficient manufacture of automobiles). On the other hand, savers, as we have mentioned, have short-term consumption plans (the purchase of the car is planned now). As they make these plans, the demand for the goods already produced or consumer goods rises, causing inflationary pressures, since not enough consumer goods are being manufactured to meet current demand (the entrepreneur is investing the credit in developing new machinery, not in speeding up automobile production). This inflationary pressure is further exacerbated as new projects compete with the rest of the agents bidding up for the same factors of production (labor, capital, raw materials). **If there were temporal coordination between savings and investment, these factors of production would be allocated to projects demanded by the savers according to their time preferences, and this pressure would disappear**.

Since this does not happen, all stages of production compete for the same resources, triggering inflationary processes of the first (e.g. wage and commodity price increases) and second order (wage increases allow more products to be demanded and, in addition, **bottlenecks** take place in commodity industries, given that supply cannot meet the growing demand, which causes commodity inflation). In addition, unless central banks try to prevent this, interest rates rise, as economic agents also compete for bank credit in order to carry out their consumption and investment plans.

Eventually, the mismatch between short-term savings (and funding) plans and long-term investment projects becomes unsustainable, as many of these projects prove to be unprofitable. A (desperate) phase of **struggle for liquidity** begins, as agents seek to refinance their debt so as not to be forced to abandon their business plans. However, financiers become more cautious in this environment and restrict the supply of credit, which puts upward pressure on interest rates, worsening the financial situation of businesses. In order to be able to repay part of the debt, businessmen proceed to abandon investment projects with poorer prospects, initiating a fall in the demand for factors of production (layoffs begin and the demand for commodities falls). However, the liquidity in the system is not enough to sustain the rest of the projects that businessmen were struggling to maintain, and the **depression** phase begins, which may be more or less pronounced. In this phase, companies go bust, its assets are liquidated and the demand for factors of production plummets, with prices falling across the board (deflation) along with interest rates (lower demand for credit).

It is at this point that the huge risk taken by the banks with the mismatching of maturities becomes apparent, as they find that their assets (loans) lose a large part of their value (the projects they back go bankrupt or generate less cash flow than expected). Moreover, since they operate with massive leverage, a small loss in their assets' value can wipe out all of the entity's equity. This is why most banks carry out large capital raises at the worst possible times, to help them avoid bankruptcy, and are forced—to a greater or lesser extent—to be bailed out by the central bank. This is one of the reasons why, historically, we have been averse to investing in the financial sector. **The maturity mismatch, together with the massive leverage, makes the financial sector (especially the banking sector) a fragile and unsustainable business in the long term**, with a few honorable exceptions in our portfolios, such as **S&U**, **AerCap** or **Catalana Occidente**, where prudent management of maturities and leverage makes them excellent businesses. I will leave, as a reflection, whether banks would take so much risk, which is so detrimental to the economy due to the lack of coordination and cycles they generate, if there were no such central bank as there is now.

Lastly, the depression phase forces a restructuring of the different stages of production in line with the savings/consumption plans of the economies. This is a painful process of **recapitalization**, although necessary for the economy to begin its recovery phase as soon as possible. Hence, most interventionist policies by central banks or governments contribute negatively to this recovery by distorting the behavior of economic agents and maintaining a situation of recession or stagnation over time.

In short, as we have just seen, the ABCT helps us to have a more global view of what may be driving the supply and demand of commodities, as well as their prices, while the classic analysis of the capital cycle focuses exclusively on the industry's supply, failing to explain what underlies demand and price formation. This is especially true in synchronized commodity cycles, where prices move in unison and where the dynamics specific to each commodity lose much of their relevance. The latest **commodity supercycle** is a clear example of this phenomenon.

The commodity supercycle

Historically, there has been a bull market in commodities every 20 or 30 years.
— Jim Rogers

The commodity supercycle refers to the widespread commodities rally experienced in the first decade of this century. Why did this supercycle begin? For two reasons. On the one hand, the sharp fall in prices in the 1990s, derived from the excess production capacity and supply of many years, led to a drastic reduction in investment in new production (remember the "investor pessimism" phase in the capital cycle analysis). On the other hand, the burst of the dotcom bubble, coupled with the impact of the terrible attack of September 11, 2001, led the Federal Reserve to **slash interest rates** (from 6.5% to 1%). This move was followed by the rest of the central banks. The aim? To give banks a boost to stimulate credit and revive economies. And indeed, they succeeded!

Banks and other financial intermediaries around the world began the process of credit expansion, by means of the **maturity mismatch** we explained earlier, taking advantage of the appetite and high debt capacity of companies and citizens in those years. The new debt was mainly used, as we all know, for the purchase and construction of new housing, triggering one of the biggest global bubbles in living memory, in which the popular belief was that house prices would never fall. The lack of coordination between savings and investment plans led to the classic competition bidding up for factors of production, contributing to wage **inflation**, consumer and capital goods inflation, as well as a rise in commodity prices. The latter faced an enormous bottleneck during the period, as a result of the scarce production capacity at the beginning of the century and the growing demand derived from this credit expansion, as well as another equally relevant factor, namely the significant growth and economic development in **China** during the period.

The result of this perfect storm? Sharp rises in the price of all commodities. Thus, if we look at some of the commodities that our portfolios have exposure to, **copper** rose by 550%, **oil** by more than 700%, **metallurgical coal** returned 900% and **uranium** was up more than 1,300% to the highs reached in 2008. Hence the *supercycle*. All these gains brought optimism back to the sector's entrepreneurs and executives, triggering **investments** in new production capacity and in the exploration of new deposits. However, widespread inflation led central banks to start gradually **raising interest rates**, precipitating the bursting of the bubbles and triggering the Great Recession that started in 2008, with the consequent bailout of banks and economies by central banks and other government agencies. The collapse in demand resulting from this economic crisis, together with the investment in new production capacity spurred by such elevated prices, led to **oversupply** in the commodities sector, causing prices to plummet. From the highs reached in 2008, **copper**, **metallurgical coal** and **uranium** lost around 70% of their value, while **oil** fell by around 80%.

Central banks around the world, as well as governments, reacted with unprecedented (at that time) **rescue/stimulus plans**, the former expanding their balance sheets and the latter increasing public spending. These actions made the liquidation of bad investments and the readjustment of the economies' capital structure extremely difficult, triggering new bottlenecks in commodities. Thus, up to the highs reached in 2011, **copper** and **oil** rose by about 250%, **metallurgical coal** by about 200% and **uranium** "only" by 75%. At that point, the necessary structural adjustment became inevitable and all commodities experienced a slump (more or less pronounced), which contributed for a few years to readjust and recapitalize the industries according to the real savings/consumption plans of economic agents.

Since then, the supply and demand dynamics of each commodity—and, therefore, the capital cycle analysis—regained relevance, creating a number of opportunities that we have been trying to take advantage of, generally with success, since 2015.

Our history of investing in commodities

The cure for high prices is high prices, and the cure for low prices is low prices.
— Rick Rule (Sprott Inc and Sprott U.S. Holdings)

Before discussing some examples of investments we have made in recent years, it is important to explain how we approach the commodities sector.

First, we analyze, using the tools discussed above, **the dynamics of supply, demand and price of the commodity**. If, as a result of this analysis, we conclude that there is a favorable situation for the sector, then we move on to the next level: choosing potentially investable companies.

This second step leads us to look for those companies that, to a greater or lesser extent, meet our **investment criteria**. Specifically, we will try to identify those players that are at the bottom of the cost curve or that operate with low capex requirements and low debt, as these two factors will protect us if the bullish thesis takes a long time to materialize or if we have been wrong in our sector analysis. In addition, we will study the historical capital allocation of management teams, as well as the shareholder structure and executive compensation plans, to try to ensure that the interests of company directors are aligned with those of their shareholders.

Finally, we will look for situations with the highest **convexity** (see **here**), that is, investment opportunities where we maximize the trade-off between risk (a scenario of permanent capital loss) and return (the upside potential we estimate for the investment).

Having clarified this, we now proceed to look at the first investment case: **copper**.

THE CASE OF COPPER

At the beginning of 2016, after spending weeks studying the sector, we decided to invest in the copper industry. We were encouraged to do so for two reasons. On the one hand, the decline in copper prices of more than 50% from the 2011 highs, as a result of the global structural adjustment due to the bursting of the bubble discussed earlier, put the industry in an unsustainable situation, in which around 20% of producers were unable to generate positive cash flows. This led to a standstill in investment in new projects. On the other hand, and no less important, future demand for copper remained strong, thanks to low per capita consumption in China, the renewable energy revolution, the development of the electric vehicle market and the prospects for electrification in countries such as India.

For all these reasons, we invested in early 2016 in the companies **Antofagasta** and **Freeport-McMoRan** ("Freeport", hereafter) and, more recently, in **Atalaya Mining**. **Antofagasta** ticked all the right boxes for investing in the sector, with copper-producing assets at the low end of the cost curve (Los Pelambres), a solid balance sheet and a shareholder base controlled by the Luksic Group. These aspects allowed it to generate cash in difficult environments and ensured a long-term value-creating approach in the management's decisions. **Freeport**, on the other hand, also had extraordinary assets (Grasberg), but past capital allocation decisions and its higher leverage made it a riskier investment. For this reason, we decided to allocate more weight to **Antofagasta**, although, as the years went by, we increased our stake in **Freeport**, due to an improvement in the company's balance sheet, the market situation and its management—the presence of activist investor Carl Icahn as a shareholder was noted here.

Shortly after initiating our positions in these two companies, our thesis on copper began to materialize, triggering a rise in price that still continues to this day and pushing copper stocks higher. Thus, **Antofagasta** quickly reached our target valuation, rising by more than 70% in less than a year. **Freeport**, which was consistently cheaper due to the initial risks already mentioned, was sold in the fourth quarter, with accumulated capital gains of about 150% (excluding the effect of the rebalancing of the position's weighting).

As for **Atalaya Mining**, the company that owns the Riotinto project in Huelva (Spain) is still held in Horos Value Iberia, with accumulated gains of close to 150% since we initiated our position in the second quarter of 2020.

We now turn to two sectors in which we still see significant upside potential: **metallurgical coal** and **uranium**.

THE CASE OF METALLURGICAL COAL

As is often the case in highly cyclical sectors, we got interested in the coal sector in the second half of 2019, following the severe decline in coal prices over the last three years. The downturn occurred in both thermal and metallurgical coal, so we studied the dynamics of both industries. Although we thought—and still think today—that there are very cheap thermal coal producers, properly managed and with strong cash generation capacity in very challenging environments, we are concerned that social pressure and political decisions might further affect the dynamics of the sector. For this reason, we decided to rule out (at least for now) investing in thermal coal.

However, we are very interested in the metallurgical ("met") coal situation. While thermal coal is primarily used as a fossil fuel in power generation, met coal is used in the steel production process. Although it also faces certain pressures and there is a risk of gradual substitution (electric arc furnaces), we believe that the demand for this type of coal will remain stable in the coming years, especially for higher quality coal. In addition to this, there is a stagnant production capacity and a lack of investments in new projects, due to the low prices at which this type of coal trades. Therefore, in our opinion, we find ourselves in another case of unsustainably low prices.

As you know, we have picked **Warrior Met Coal** to invest in this sector. One of the few pure-play met coal producers, with a premium product (similar to Australia's benchmark metallurgical coal), a very solid balance sheet, a flexible cost structure and strong cash generation capacity.

THE CASE OF URANIUM

We have already analyzed the dynamics of this chemical element before, so we are not going to discuss it again here. However, I recommend watching the presentation I gave at the Value School Summer Summit, entitled "Value Investing throughout the capital cycle. The case of uranium" and uploaded to our YouTube channel last November (watch here). As the title indicates, I explain the history of uranium through the different capital cycles it has experienced, with emphasis on the current one and the investment opportunities that are presented to us.

To end this section, we will discuss one last investment case in commodities. An industry that has given us both joy and pain in equal measure: **oil**.

THE CASE OF OIL

As usual, the collapse in the price of oil, driven by the same reasons we have discussed for other commodities, sparked our interest in this sector. After our initial analysis, we found a market situation in which investment in production was beginning to contract and demand was struggling due to the consequences of the excesses of the past bubble. Faced with an extremely uncertain outlook, we decided to invest in the sector at the end of 2014 through two companies where getting the thesis wrong would not mean losing money, because they had business models that were not very capital-intensive and an extremely cheap valuation that gave us a high margin of safety. We are talking about **TGS-NOPEC** ("TGS") and **Applus Services** ("Applus").

TGS is dedicated to providing the oil and gas industry with data on the geological and physical properties of onshore—conventional and unconventional—and offshore oil fields. In order to obtain this data, **TGS** carries out explorations by renting the machinery used (e.g., ships). This allows the company to be able to drastically reduce its capex in challenging environments, continue generating cash and take advantage of the opportunities that arise in a time of depressed investment.

For its part, **Applus** has several certification, testing and inspection divisions in industries as diverse as automotive, food and energy. At that time, **Applus** had more than 50% of its revenues coming from the oil and gas sector, so its share price was severely punished. However, as with **TGS**, **Applus**' model does not require much capital employed and, additionally, its industry diversification protected it from very adverse scenarios.

In both cases the return we had was positive, over 30% in **Applus** and close to 100% in **TGS**, excluding the positive contribution of the portfolio rebalancing when we were shareholders.

However, this is not the end of our more recent history regarding the oil sector. As time went by, it became evident that a great deal of investor pessimism had taken hold of this industry. On the one hand, lower expected growth in many economies (China in particular), greater efficiency in energy consumption and the adoption of electric vehicles led in recent years to forecasts of a sharp slowdown in oil demand growth. On the other hand, the production boom in the United States thanks to the shale oil revolution and fueled by continuous productivity improvements, led the market to predict a kind of permanent surplus in the industry and, as a consequence, an era of 'lower for longer' oil prices.

Our outlook, however, was not so negative. We even thought that, if producers did not take action, the reality would be just the opposite: an oil market in deficit and high prices in the following years. The reasons? On the demand side, even if we were optimistic about the adoption of electric vehicles, we did not see the collapse that many predicted. On the supply side, the pace of U.S. shale oil production growth looked unsustainable to us, given its expected drop in productivity and, especially, because of the (extraordinarily) cheap financing that projects were getting, despite the low/zero returns of many of them. That said, even if the shale industry held out for longer than we expected, there was another very relevant factor in the supply equation that could not be ignored: the rate of decline of conventional fields remained steady. If oil prices did not rise to certain levels, there would be no investment in new production, so we were faced with the situation we always look for when investing in a commodity: a potential bottleneck.

With this background, we studied how we could take advantage of this imbalance and, after comparing the different alternatives, we decided to go for the companies that own offshore oil rigs or oil platforms.[8] Why the offshore platforms? Oil companies had drastically reduced investment and operations in offshore fields, particularly deepwater fields, because of their poorer returns in a low-price environment. However, with the prospect of the potential bottleneck that we anticipated in our analysis, we were convinced that investment and operations in offshore wells would recover, benefiting the companies that own oil platforms. It was just a question of which one to invest in.

Finally, in mid-2017, we decided to invest in **Borr Drilling**, a recently created company that had acquired a fleet of jack-up rigs at knock-down prices, taking advantage of the fragile situation of some players in the sector. These rigs are used for exploitation in shallow or very shallow waters, which would be the first to be reactivated if investment in the sector was coming back. The company also had a debt-free balance sheet, which meant that we did not incur financial risks. The oil price, which had already been recovering some ground for a few months since the lows of 2016, continued to rise in the months following our investment in **Borr Drilling**. As a result, the stock rallied and we had a gain of about 60% in the short time we were invested. In addition, we decided to change our investment vehicle in this sector to another company that gave us exposure to the next area of the industry recovery and, therefore, it had greater leverage: **Valaris** (formerly Ensco).

The U.S. company was, at the time of our investment, one of the most important players in the sector, with a rig fleet of more than sixty units, 60% of which were jack-up rigs, the remainder being rigs specialized in deeper waters (e.g. floaters). Thus, it was an investment with higher risk and illiquidity in its business, since cash flows would take longer to be generated. As with **Borr Drilling**, the position soon paid off and we had gains of close to 100% in a few months—although we did not sell all our shares.
However, our thesis on the sector soon began to deteriorate, especially on the supply side. On the one hand, U.S. shale oil production, far from slowing down, continued its relentless growth. On the other hand, as a consequence of the above, the reactivation of deepwater wells was taking place at a slower than desirable pace, which meant that rig rates remained depressed, further reducing the asset valuation of the companies that owned the fleets, such as **Valaris**. In addition, **Valaris** had significant financial leverage, backed by the valuation of its assets. If the thesis took too long to be realized, the value of the fleet could deteriorate as the flows expected by the company would not materialize, hindering its ability to

[8] Along the way, we also invested in the engineering companies Técnicas Reunidas and Petrofac, making significant gains.

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meet the debt, as well as the operational and investment needs of the business. Additionally, the fleet could become less attractive if the company had to divest some of their rigs. In other words, **Valaris**' business (and that of other companies in the sector) could suffer a significant liquidity deterioration.

The pain did not take long to hit the stock market, with sharp stock price declines for the company and the rest of the sector. With hindsight, it is easy to see that we should have exited our investment in **Valaris** at that time. However, we chose an intermediate solution: we reduced our exposure to **Valaris**, invested again in **Borr Drilling** and initiated a new position in **Shelf Drilling**, keeping our total exposure to the sector stable and partly reducing the financial and operational risk we were taking on. We soon saw that the move was not going to pay off because of the severe downturn that followed due to a dual shock. On the one hand, the production agreement between Saudi Arabia and Russia was broken up, ending the former's policy of production cuts and triggering a historic intraday drop in oil prices of more than 30%. On the other hand, the impact of the COVID-19 pandemic on oil demand was the final blow to the sector.

As for us, at the end of February, before the sector suffered these two tremendous blows—which were impossible to foresee—we decided to liquidate our investment in **Valaris** with heavy losses, as we came to believe that the thesis was not going to be realized at all. In addition, we decided not to increase our stakes in **Borr Drilling** and **Shelf Drilling** after the collapse they experienced, leaving them with a tiny weight. Soon after, we exited **Borr Drilling** as well and, since then, we have maintained a very small position in **Shelf Drilling**.

So, what mistakes did we make in our investment in the offshore platforms? As can be seen from the above discussion, we were wrong in our analysis of oil supply, in assuming that rationality would soon come to the U.S. oil debt market and in underestimating the ability to maintain the high productivity of the wells. On the other hand, perhaps more painful, we were overly optimistic in our baseline scenario, underestimating the liquidity risk of the business of the companies in which we invested, by assuming that the value of the rigs could safely back the liabilities of these entities.

In short, a clear and forceful example of why we can **NEVER** err on the side of optimism in the valuations of the highly cyclical businesses and, especially, with regard to their debt and liquidity risk, because time will **ALWAYS** work against us.

Main changes to our portfolios

We have no control over outcomes, but we can control the process.
— Michael Mauboussin

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

HOROS VALUE INTERNACIONAL
Stake decreases & exits:

FINANCIALS
Exposure stable at 22.2%
Holdings discussed: Catalana Occidente (4.5%), Qiwi (exited) and KKR (exited)

Although we are maintaining a stable exposure at the sector level, there have been several adjustments, new stakes and exits that are worth discussing.

We trimmed our position in **Catalana Occidente** due solely and exclusively to the excellent share price performance since we initiated it, up around 85% at the time of writing. We continue to believe that, at current prices, the market is underestimating the quality and profit-generating capacity of its credit business, the stability and recurrence of traditional insurance lines, as well as the large excess reserves that the company holds on its balance sheet for potential M&A opportunities that may arise. Hence, although with a lower weight in our portfolio, the company is still one of our top holdings.

The exits of **KKR** and **Qiwi** were for very different reasons and following very different performance. In the case of **KKR**, we sold the entire stake when it became unattractive to us, given the stock's good performance and the new opportunities that arose. As for **Qiwi**, we divested our position in two phases. First, we drastically trimmed it to only 1% of the fund after the company's latest earnings report. Despite the excellent numbers released, the management team became very cautious due to some regulatory threats that they saw on the horizon, which could affect (in the worst-case scenario) the betting segment of its payments business—a very important source of cash flow for the company. On top of this, there were the continuous attempts by the management team to sell shares every time the stock approached 20 dollars, sending a clear message about its future prospects for the business. Second, in mid-December the banking regulator ordered restrictions on foreign transfers, as well as on the reloading of prepaid cards provided by the company, in an attempt to tighten its money laundering control policy. In the face of this uncertainty, we decided to sell the remainder of our **Qiwi** position, as we believe that the risk-return trade-off has deteriorated sharply.

TECHNOLOGICAL PLATFORMS

Exposure trimmed from 5.4% to 4.1%
Holdings discussed: Baidu (2.2%) and Naspers (1.9%)

Indeed, we could replicate the comment we made in our previous quarterly letter, given its validity: *We continued to gradually trim exposure to the technology platforms segment. A high-quality sector, in which we have maintained a significant historical weight in our portfolio. However, as we have always stressed, the margin of safety is the most important factor in obtaining sustainable returns over time and the current market dynamics are leading these companies to become more expensive at a dizzying rate.*

That said, this quarter, in addition to continuing to trim our stake in **Naspers** (the South African holding company through which we invest in the Chinese technology platform company **Tencent**), we also reduced our exposure to the other Chinese technology giant we hold in our portfolio: **Baidu**. As we have already highlighted in prior letters, the company has managed—after some very challenging quarters—to refocus its services and develop its own ecosystem around its super app Baidu App, to face the threats posed by WeChat (**Tencent**), Alipay (**Alibaba**) and other recently created apps, which have huge acceptance and growth in the country. Finally, **Baidu**'s share price has rewarded these efforts, with a share price rise of over 100% since the March lows.

OTHER

Trimmed 0.9% of the fund
Holding discussed: Brookfield Property Partners (3.0%)

We trimmed our exposure to this real estate company, following the excellent performance of **Brookfield Property Partners'** ("BPY") stock during the period. This can be explained by several factors, including the share buybacks that the company has been executing in the second half of the year, as well as the improvement of the situation in the shopping centers owned by **BPY** in the United States, where rent collection has shown significant progress in recent months.

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However, although outside the period covered by this letter, the most noteworthy event occurred on January 4 of this new year, with the announcement of **Brookfield Asset Management** ("BAM")'s takeover bid for the remaining shares of **BPY** that it does not control, at a price of 16.5 dollars per share (a premium of 14% over the December close). The price seems to us to be far below the valuation that, in our opinion, **BPY** deserves—e.g., its last reported NAV stands at 26.80 dollars—so we will hold the position, awaiting a potential increase in the offer price. In fact, on previous occasions, **BAM** has proceeded in this way.

Therefore, we find ourselves with another example of the attractive price at which the companies we hold in our portfolios are trading and how—in the case of family businesses or similar—the controlling shareholders are taking advantage of the situation to try to get hold of the rest of the shares they do not own. This always leaves a bittersweet feeling for us as shareholders, as the transaction is made at prices far below our target valuation (as in the case of **Clear Media** or **Sonae Capital**), but it helps to uncover the value of our investments more quickly.

Stake increases & new stakes:

FINANCIALS
Exposure stable at 22.2%
Holdings discussed: AerCap (5.1%), Semapa (4.1%) and GAMCO Investors (0.6%, NEW).

As noted above on the stake decreases and exits, despite maintaining a stable exposure to the financial sector we made significant changes in the fourth quarter. We now turn to discuss the stake increases in **Semapa** and **AerCap**, as well as the new position in **GAMCO Investors** (0.6%).

Semapa is a Portuguese holding company that owns 69.4% of the paper company **The Navigator Company** ("Navigator"), as well as having divisions in cement (Secil) and environmental services (ETSA Group). Although **Navigator**, like the other divisions, has been affected this year by the COVID-19 pandemic, we believe that the results have shown greater strength than we might have initially expected. Thus, **Navigator** has managed to maintain EBITDA margins at very respectable levels (even above 20% in the third quarter), generating cash in 2020 and, most interestingly for **Semapa**, distributing a high dividend in such a difficult year. Despite this, the market continued to heavily weigh down the share price, so we took the opportunity to increase our stake, given **Navigator**'s good prospects for the coming years as the economy recovers.

Regarding **AerCap**, we believe that the high uncertainty surrounding its aircraft leasing business has slowly begun to subside. On the one hand, the relatively greater global control over the pandemic and the work of airlines to increase flight safety to the best of their ability has allowed a gradual recovery in air traffic. Although, realistically, it is still far from desirable levels, the trend is positive. On the other hand, the eagerly awaited vaccines to combat COVID-19 may mark a definitive turning point for the airline industry, once the population begins to be immunized. While we are well aware that the scenario may change again (new, more contagious strains, less effective vaccines than expected or new lockdowns), we believe that **AerCap**'s financial and liquidity risk has been drastically reduced.

In addition, the management team has demonstrated its ability to adapt to this environment by renegotiating with **Airbus** and **Boeing** a very significant delay in the purchase of new aircraft, thereby reducing its investment needs, as well as taking advantage of the easing of capital markets to refinance debt at lower rates. Finally, the company realized an impairment in the fleet value of just over $900 million last quarter, impacting the risks of expected cash flows for its older aircraft. After this impairment (the only and last one they expect to make), **AerCap**'s NAV stands at 69 dollars per share at the end of the third quarter, 50% above its share price at the time of writing and despite having risen by 330% from the lows reached during the worst of the crisis.

Lastly, this quarter we initiated a position in **GAMCO Investors** ("GAMCO"). Followers of the value investing philosophy will be familiar with this asset management firm, which was founded in 1977 by legendary investor Mario Gabelli, who today holds the positions of Chairman, CEO and Co-Chief Investment Officer. **GAMCO** has nearly $30 billion in assets under management, comprising its own mutual funds and a range of portfolio and wealth management services for institutional clients and separate accounts.

Like most active asset managers, **GAMCO** has suffered heavy net outflows in the last few years, losing more than thirty percent of AUM since the 2017 peak. However, we believe that, at some point, active managers will eventually add value again to their investors and we are confident in the expertise and good work of Gabelli and his team. Moreover, even assuming a very conservative cash generation scenario for the next few years, we are buying this historic asset manager with an extraordinarily high margin of safety, trading below 6-7x current earnings.

OTHER
2.3% of the fund
Holding discussed: Liberated Syndication (2.3%, NEW)

Liberated Syndication ("LSYN") is a company with a division that provides hosting and other services for podcasts (Libsyn), as well as other services, such as domain registration and hosting for websites (Pair Networks). Although Pair Networks contributes significantly to the company's cash flow today, **LSYN**'s current and future focus is on its Libsyn segment. The podcast industry is experiencing years of strong growth, thanks to the massive adoption of smartphones and the increasing quality of the content offered. Libsyn is one of the leaders in hosting services, with more than 75,000 hosted programs at the end of the third quarter and a combined audience of 130 million monthly active users, showing double-digit annual growth in both figures. The company is therefore well positioned to benefit from this structural growth trend.

At the industry level, it is interesting to note that this is a highly fragmented sector, in which there have been numerous corporate developments in the last two years, led by the recent interest of the major technology players. Especially relevant, in this regard, is the role played by **Spotify**, which has made several acquisitions and signed multi-million dollar exclusivity deals with top trending podcasts, as is the case of The Joe Rogan Experience.

However, our interest in **LSYN** is not only based on the good prospects of its business. The changes that have taken place in the corporate leadership may bring a major turnaround in its management and ultimately contribute to our returns as shareholders. Specifically, in October 2019, the company's Chief Financial Officer resigned in the face of the SEC complaint upon detecting bad accounting and communication practices at FAB Universal, former holding company that owned **LSYN**. The SEC complaint was also against the CEO, who resigned in August 2020, after reaching a financial settlement in mid-2020.

Apart from the SEC complaint, it was the shareholder CAMAC, with an activist role, which managed to reshuffle the management team, after a long time publicly fighting against the poor compensation practices of these executives and their capital allocation decisions. Following these changes, CAMAC has gained several seats on the Board, the company has hired a highly experienced CFO and is looking for a CEO to help implement the strategic changes approved by **LSYN**, focused on playing an active role in the consolidation of the sector, as well as updating its podcast advertising service and preparing its up-listing to the NASDAQ—today, **LSYN** is listed on an OTC market, which reduces the company's visibility and liquidity, as it is not covered by analysts and is away from the institutional investor's focus.

Finally, in a recent turn of events, almost at the same time as we invested in the company, **LSYN** announced that it had filed a lawsuit against several shareholders resulting from the merger of a Chinese company with the former holding company that owned **LSYN**. After the merger, **LSYN**'s former management team discovered the accounting fraud committed by this Chinese company, whose managers ended up in jail. Now, the company's new management team claims that, after studying the case documents in detail, these shareholders fraudulently acquired a stake in **LSYN** and should be forced to dispose of their shares. If they achieve their goal, the company would subsequently redeem these shares, significantly reducing **LSYN**'s capital and increasing the stake (and value) for the remaining shareholders. This news undoubtedly pushed the share price up further, with a 50% gain in the closing weeks of the year.

Therefore, this is a company with an attractive growth profile, a very solid balance sheet (with net cash), a strong cash generation capacity and a management team committed to uncover value for its shareholders.

HOROS VALUE IBERIA
Stake decreases & exits:

FINANCIALS
Exposure trimmed from 21.0% to 16.7%
Holdings discussed: Catalana Occidente (7.0%) and Sonae Capital (exited)

As we discussed in our previous quarterly letter, **Sonae Capital** received a takeover bid from Efanor, the investment vehicle controlled by the Azevedo family (the company's management team), at a price of 0.70 euros per share. At the time, we slightly trimmed our stake in the Portuguese company, given the other investment opportunities available to us at the time and waiting on a likely increase in the price offered by Efanor. Finally, the increase came at 0.77 euros per share and, given the impossibility of obtaining a higher return on this investment, we decided to divest the entire position.

As for **Catalana Occidente**, the reasons for reducing its portfolio weight—and keeping it among the fund's top holdings—coincide with those set out in the Horos Value Internacional commentary.

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OTHER
3.0% of the fund
Holding discussed: Greenalia (0.8%)

Like other publicly traded companies in the renewable energy sector, **Greenalia** has rallied since our initial investment—it rose by more than 80% in 2020 alone. This led us to significantly trim the position, given its lower margin of safety and in the context of other more attractive alternatives at the present time, discussed below.

Stake increases & new stakes:

REAL ESTATE
Exposure increased from 12.6% to 14.8%
Holding discussed: MERLIN Properties (7.9%)

We continued to increase our stake in this REIT (SOCIMI in Spanish) for two main reasons. On the one hand, **MERLIN Properties** ("MERLIN") has continued to demonstrate the robustness of its assets and the good performance of its management team in its latest earnings report, supporting our investment thesis. On the other hand, the exit or stake decreases in other investments with less potential has freed up cash, which we used to increase our exposure to companies with a greater margin of safety currently, such as **MERLIN**. This is why we made it Horos Value Iberia's top position.

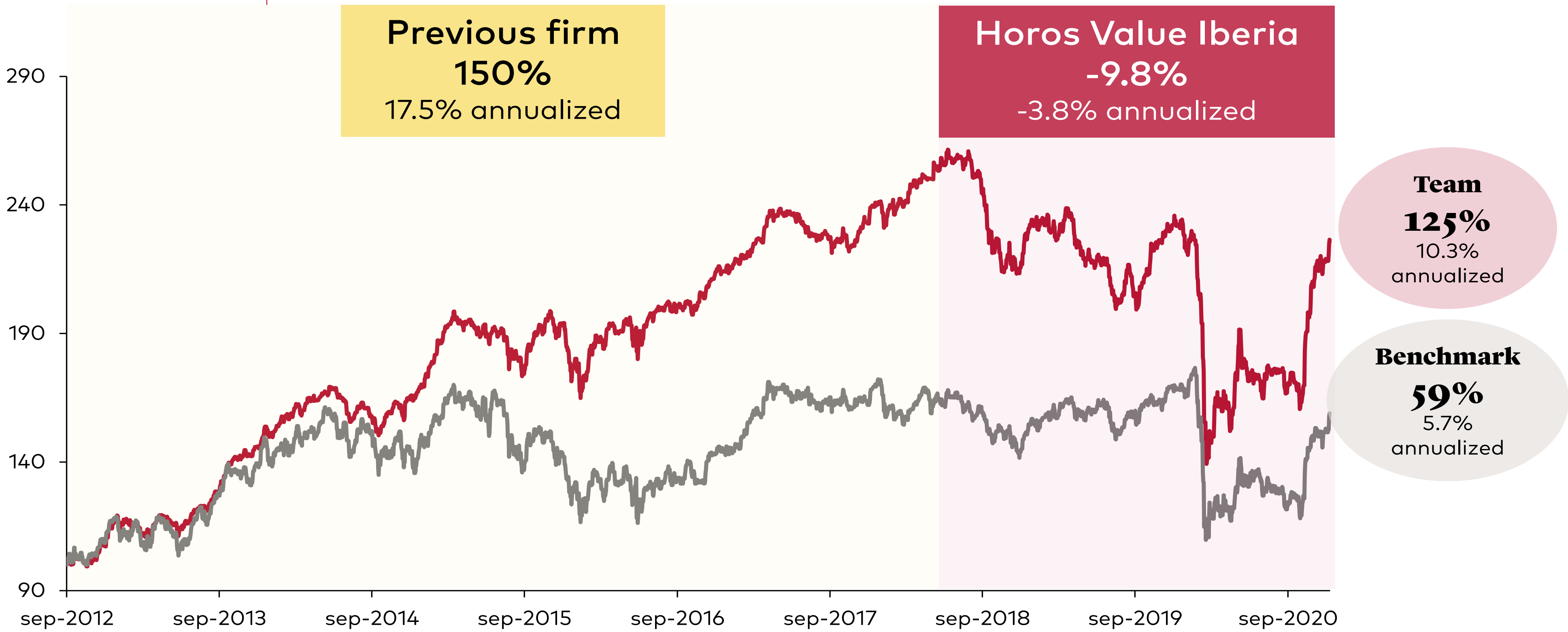
OTHER
1.9% of the fund
Holdings discussed: Grupo Elecnor (5.8%) and Ence (2.8%, NEW)

Ence is a pulp and renewable energy company, which we decided to add following the sale of 49% of its energy business, which is not related to the pulp activity. This sale has helped to enhance the value of the energy division (in our opinion, the market was undervaluing it) and has also enabled the company to considerably reduce its debt ratios, at a bad time for its pulp sales division, given the depressed prices at which this product is currently trading. In fact, we believe that this is precisely where the investment opportunity lies. If we use the valuation of the energy segment transaction for the rest of **Ence**'s business, we find that the market valued the pulp division at virtually zero. An inefficiency that cannot last long, as the current selling prices of pulp are unsustainable, since there are many producers who cannot generate cash in this environment.

Interestingly, a somewhat similar situation arose for **Elecnor**, the Spanish company with divisions in engineering, wind energy (Enerfin) and high-voltage line concessions (Celeo). At the beginning of the fourth quarter, **ACS** announced the sale of Cobra, its engineering subsidiary, to the French company **Vinci**, for around 5.2 billion euros. Well, if we apply the multiple paid by **Vinci** to **Elecnor**'s engineering division, we find that the market is not assigning any value to the company's wind energy and concessions divisions. However, the lack of analyst coverage of **Elecnor** and its low liquidity mean that this inefficiency persists, so we used the cash to increase our stake in this excellent company.

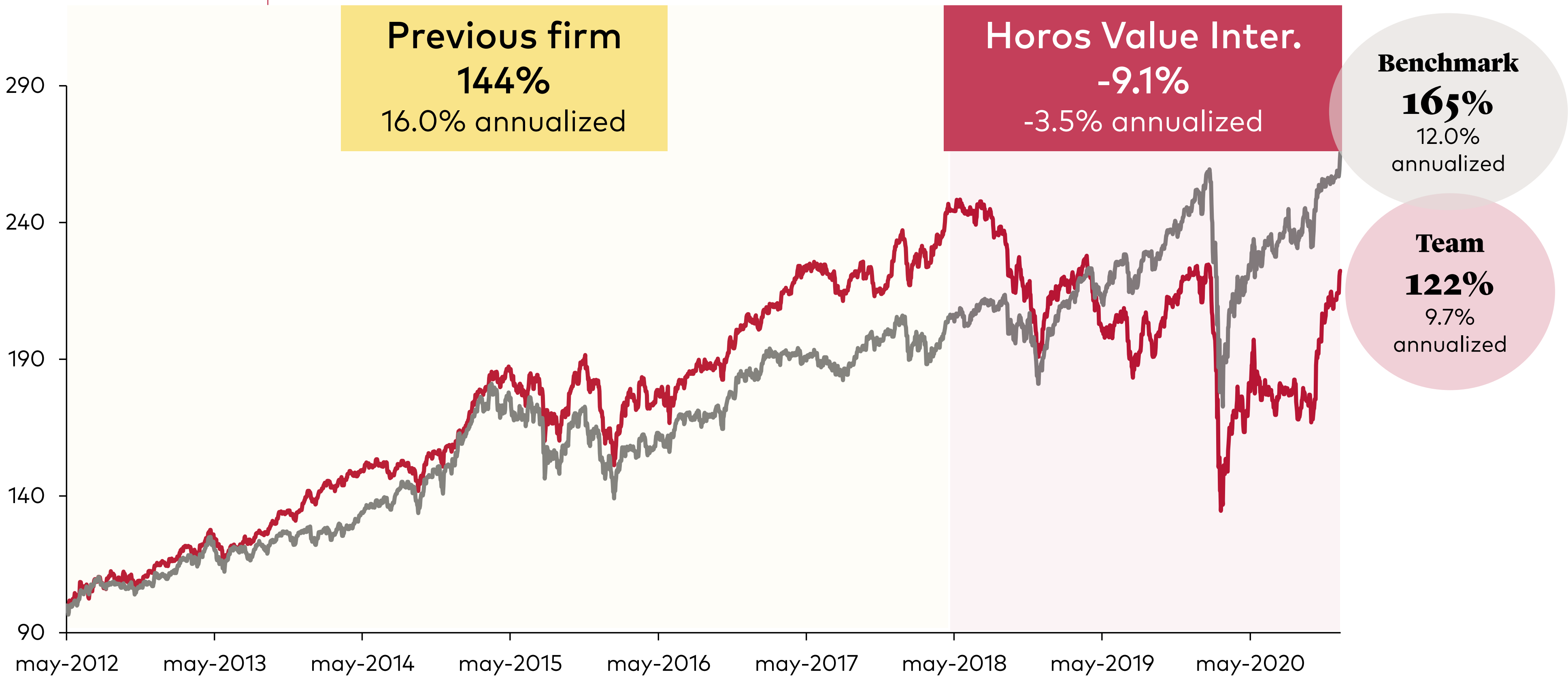
Returns

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



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

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



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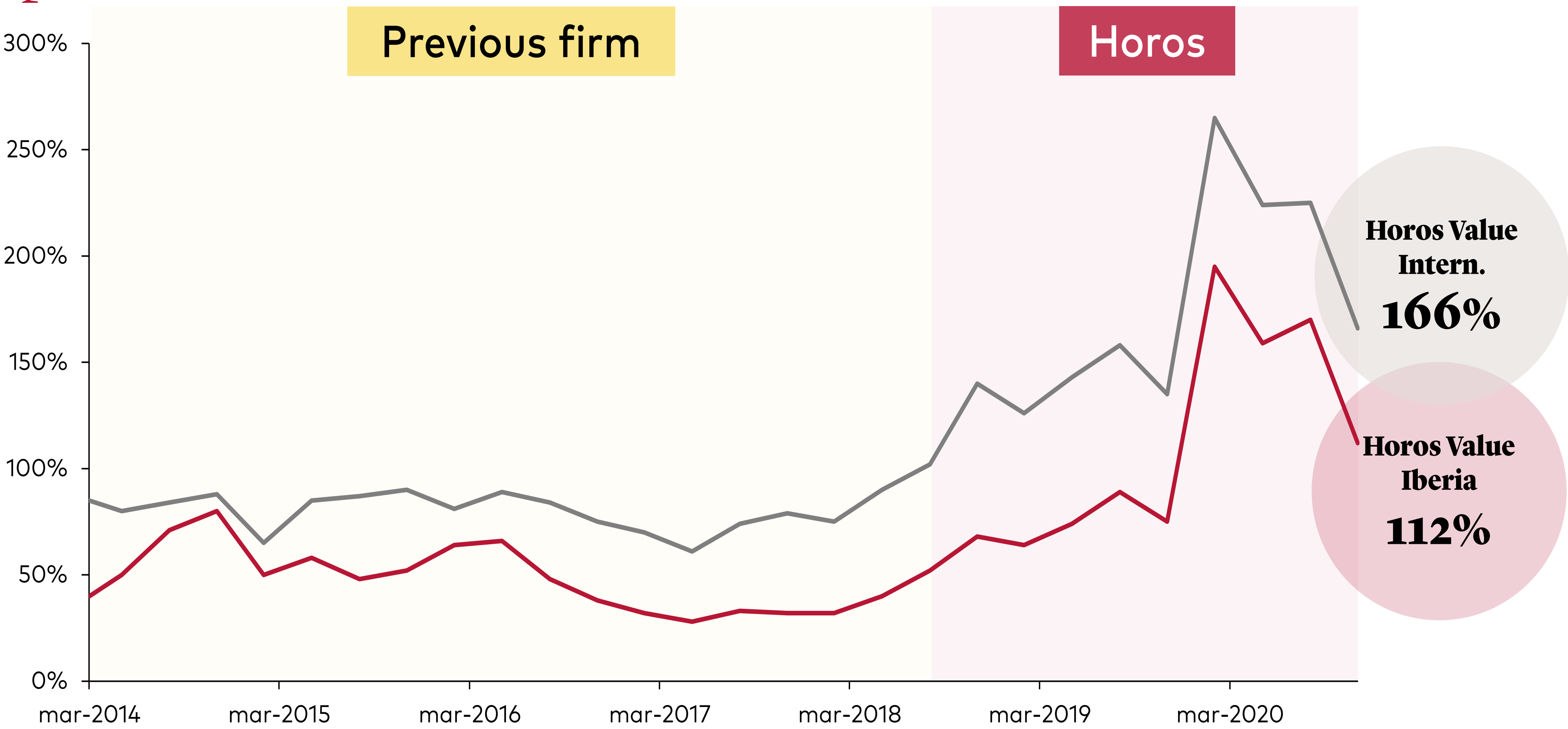
Upside potential

Historical potential of the management team

Data from 31 March 2014 to 30 September 2020

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



Top 10 Holdings
Horos Value Iberia

Holding	%	Theme
Merlin Properties	7,9%	Real estate and construction
Catalana Occidente	7,0%	Financial
Semapa	6,5%	Financial
Elecnor	5,8%	Engineering
Horos Value Internacional	5,8%	Financial
Sonae SGPS	5,3%	Distribution
Gestamp	5,3%	Industrial
Meliá Hotels Int.	5,0%	Cyclical consumer
Aperam	4,8%	Commodities
Altia	3,8%	TMT

Top 10 Holdings
Horos Value Internacional

Holding	%	Theme
Aercap Holdings	5,1%	Financial
Catalana Occidente	4,5%	Financial
Semapa	4,1%	Financial
Asia Standard	3,9%	Real estate and construction
Yellow Cake	3,8%	Commodities
Keck Seng Investments	3,7%	Real estate and construction
Teekay Corp.	3,7%	Commodities
Uranium Participation	3,7%	Commodities
Warrior Met Coal	3,6%	Commodities
Aperam	3,2%	Commodities