August 19th, 2019

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Dear investor,

The underlying reason for writing a letter is to inform you of the results we have obtained from our efforts over the last quarter. As you know, and as we have said many times before, this letter ought to be written every five years as this is our minimum investment horizon. However, we also believe in transparency and that our investors should have all the necessary information to judge our work. It is in this spirit that we are once again writing to you.

The tables below show our funds' performance compared to their benchmarks in the first half of 2019 and from a longer-term perspective, since their launch at the end of 2015. The individual return of each investor depends on the net asset value at which they subscribed:

	Jan-June
Azvalor Internacional FI	9,8%
MSCI Daily Net TR Europe Euro**	16,2%
Return vs Index	-6,4%

** Includes dividends

	Jan-June
Azvalor Iberia FI	3,3%
85% IGTBM** / 15% PSI 20 TR	10,5%
Return vs Index	-7,2%

** Includes dividends

	ITD*
Azvalor Internacional FI	17,3%
MSCI Daily Net TR Europe Euro**	16,2%
Return vs Index	1,1%

** Includes dividends *13/11/2015

	ITD*
Azvalor Iberia FI	16,9%
85% IGTBM** / 15% PSI 20 TR	8,1%
Return vs Index	8,8%

** Includes dividends *13/11/2015

Let me first point out that the performance data presented above gets worse if we update it from January to August 9th, with a YTD return for the International portfolio of +0.1% (vs +12.3% obtained by the index) and of -1.1% for the Iberian portfolio (vs 5.4%).

So, let me put this into context.
In our previous letter (which I recommend you read again) we articulated four messages:

1. Stock markets are expensive.
2. We are witnessing an unprecedented bubble in the history of fixed income (see graph below) where the sum of the total value of the US stock and fixed income markets has reached a peak percentage of GDP since 1940 by the end of 2018, and has since been surpassed this peak in 2019.
3. The discrepancy in valuation between the most expensive and the cheapest companies is greater than ever or, at least, as high as during the dotcom bubble 20 years ago.
4. Our portfolio is very cheap.

Therefore, given the lowly valuation relative to the quality of the companies in which we have invested, we believe our portfolios have a great future lying ahead of them in the long-term, despite the fact that the market insists on contradicting us recently.

In short, far from doubting if we have done something wrong we remain as convinced as ever that we are in the right assets. Today, the opportunity appears to us even clearer as we are seeing more and more symptoms of the speculative mood and irrationality in the market. These are signs that remind us of other periods we have lived through professionally, or periods we have read about.

After more than 20 years of investment experience, and despite having managed to beat the market, I can assure you that we at Azvalor have deep respect for the market and are very cautious NOT to contradict it lightly. But, at the same time, we are perfectly aware of its historical tendency, from time to time, to alternate between periods of euphoria, panic and to sometimes make "big" mistakes.

Indeed, in our view, we see many similarities today with the year 2000 as we have a market where what is popular rises with bad news and what is unpopular is crucified under any pretext. We believe this is a market that is ceasing to 'calculate'. Far from being exhaustive, below is a list of clear signs of a speculative and irrational market:

- The potential economic slowdown is good because it will be an alibi for new doses of stimuli (money printing from central banks) and once again becomes the dominant mantra.
- Passive asset management is becoming a "mania" (JP Morgan calculates that it already accounts for 60% of the value of US stock markets). Let us not forget that these vehicles invest automatically without considering fundamentals or valuations.
- 25% of the world's bonds trade with NEGATIVE nominal yields, including some European corporate issues rated as "junk" bonds.

- The ESG (environmental, social and governance) and political correctness phenomena are leading a growing number of institutions to completely disregard sectors that are absolutely essential to maintain global income and well-being.
- Bitcoin and other major cryptocurrencies are approaching their historical highs again and setting daily trading volume records.
- Companies with seductive but unproven business plans are reaching absurd valuations. 2018 has seen a record number of companies going public at a loss (reaching 80% in some quarters) or the highest level since the dot com bubble (see graph below). Examples include Beyond Meat, a company that went public last May, which has risen 550% and is today capitalized at $14 billion and is estimated to sell $240 million this year (valued at almost 60x sales) … and lose money! The company manufactures and sells non-meat, vegetable based products such as hamburgers. Other examples include WeWork, Tesla, Uber, Crowdstrike., all of which enjoy lofty valuations that we feel create significant and under-appreciated risk.
- The use of stock options by managers of companies in the social media/digital/apps sector (Dropbox, Twilio, Splunk, Workday…) is reaching absolutely abusive and unjustifiable levels of between 20% and up to 60% of sales in some cases! And, judging by companies' share prices, their compensation policies are backed or unknown to their shareholders.
- The stock market value of the group of companies known as FANGMAN (Facebook, Amazon, Netflix, Google, Microsoft, Apple, Nvidia) is already as much as half the sum of the value of all the companies listed in the UK, Germany and France!
- More directly related to our portfolios, since the lows of 2016, crude oil prices have surged by 110% whereas the oil industry services sector has had a 40% decline.

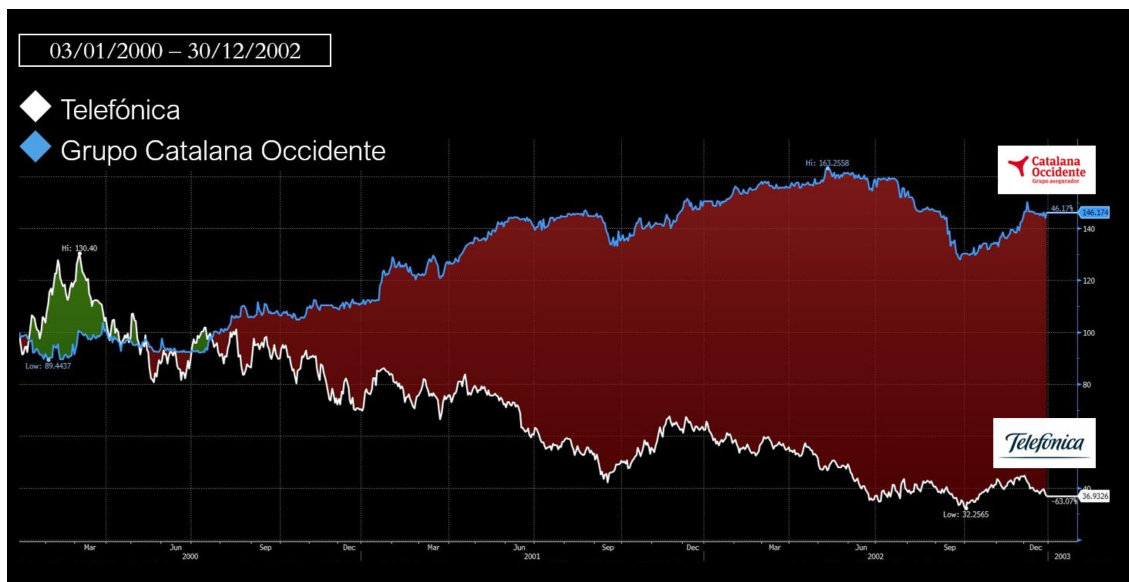
The bursting of the dot.com bubble in early 2000 resulted in an 80% drop in the Nasdaq and a significant revaluation of what was left behind. The bubble burst that happened then seemed obvious

and was backed by plain common sense. But while the bubble was at full capacity it was very difficult for us to go against the tide - to avoid the temptation of participating in the fantasy of unlimited growth and the "party" of profitability. We had to avoid such excesses by maintaining our conviction in our chosen investments despite losses in what was believed, by others, to be obsolete or "old".

An iconic example of the "collective madness" generated by the Internet bubble was brilliantly and cryptically summed up in a 2002 Bloomberg interview with former Sun Microsystems CEO, Scott McNeely. Sun Micro shares, which rose from $5 to $64 between 1996 and 2000 and then fell right back to $5, peaked at 10x sales. Investors demanded an explanation. McNeely simply posed the question "what were they thinking" … in deciding to pay such inflated prices.

Some examples closer to most readers of this letter come to mind, such as the story of Terra whose shares skyrocketed from €3-4 up to more than €160 and later plummeted to €1. We remember them vividly because for a long time in the eyes of some, we were "looking stupid" as we lagged the crowd!

The following figure illustrates what happened to a dot.com "darling" like Telefónica (white line) and an "old economy" company like the insurance company Catalana Occidente (blue line).



Indeed, the market may be extremely inefficient in the short term, but in the long term it tends to correctly reflect the value of the assets – an obvious conclusion for those of us who have managed money for many years.

In our view, the recent performance of many of our investments provides important "clues" about the patent lack of insight and calculation in the market. What makes this observation so important is that as it turns out, the latest declines have paradoxically occurred when the fundamentals of our chosen companies were improving. Let us look at a few examples:

Cameco (7,72% In Azvalor Internacional*)

the results for the second quarter of 2019 were slightly better than expected and, more importantly, we are seeing more and more indicators of recovery in the uranium market:

- Demand continues to grow and has already surpassed pre-Fukushima levels.
- China and India are accelerating the construction of new power plants.
- Some utilities have already begun to sign long-term contracts at prices that are considerably higher than spot prices or indeed term prices.
- Price recovery of intermediate products/processes of the uranium cycle suggests tightening in the nuclear fuel supply chain.
- The supply discipline of the main producers, Cameco and Kazatomprom, continues, With Support from additional closure of some smaller mines, such as Orano's uranium mines in Niger.
- An increasing number of institutions of all kinds are defending nuclear energy as a necessary part of the solution to meet the world's energy and emission reduction needs.

In spite of the above, Cameco's share price has plunged by 22% in the last month and are again close to historic lows, and over 80% below their previous highs. At current prices, Cameco trades at a normalized P/E ratio of 6.5x, without debt, and continues to be one of the most efficient producers in a growing market.

Buenaventura Mining Company (10.65% in Azvalor International*)

After reaching a recent peak of $17.5 per share, boosted by the recovery in gold and silver prices, shares have dropped by more than 10% following the latest quarterly results. The disappointment came from the lower production and lower grades in its Cerro Verde copper mine, which is actually due to special, non-repeatable stripping work already completed. The company clarified that it projects a significant improvement in production volumes and costs in the short term. Interestingly, this situation went practically unnoticed by the very few analysts who cover it.

In Buenaventura we accumulated a positive return of almost 30%. However, we believe its share price is NOT only far below its value, but has not reflected at all the recent rebound in gold and silver prices.

Tullow Oil (6,45% In Azvalor Internacional*)

Tullow shares have fallen by 25% from 2018 highs, with the cutbacks applied after the second quarter results, which "displeased" the market. Once again, this decline in prices was driven by temporary circumstances with no material impact on the value of the company (a slightly lower production than expected in Ghana due to technical problems and the delay in granting approval to one of its main growth projects in Uganda). Exploration success in Guyana - subsequently made public - mitigated some of the earlier price falls, which at one point reached a nadir of 35% from the highs reached in 2018. We believe this successful development in Guyana could alone have a impact on its value.

At current crude oil prices, Tullow trades at less than 65x profits, a valuation that "discounts" an overly pessimistic scenario. According to our calculations, crude oil would have to remain at about $45 barrel in the very long term to justify current stock prices, and even in that scenario we would see no risk of losing money. Bearing in mind the severe crisis that has affected this sector and the strong contraction of investments over the last 5 years, we believe the probability of such a scenario is rather remote. On the contrary, we think the market attributes a probability close to zero to the occurrence of a medium-term crude-oil deficit, a scenario that we believe cannot be ruled out.

Consol Energy (6,56% en Azvalor Internacional*)

Consol shares have plunged 44% so far this year and hit historical lows since the group was spun-out from CNX Resources. There are a number of reasons for this but the main reason is that gas prices in the US have again tumbled close to the severely depressed lows of 2016. However, we believe these prices are unsustainable in the long term (as evidenced by the fact that in 2016 they barely lasted a few weeks), because 100% of producers would lose money. At the same time, US gas producers are being punished by the market just as much as or even more than Consol. In other words, the market seems to be assuming sustained low prices for coal that would not only jeopardize most of the country's mines (bear in mind that Consol is the most efficient producer and coal is still 30% of the mix today) but also lead gas producers to cut production. This seems incompatible to us.

Consol is the best and most efficient thermal coal mining company in the United States, with abundant reserves, a strong balance sheet and a great management team. Nevertheless, it trades at 3x normalized earnings, and 2x 2019 earnings! It has recently reported strong results and announced its share buyback plan, which we believe will generate great value for shareholders.

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*At the end of the quarter

As we said at the beginning of this newsletter, our portfolios have so far this year underperformed the wider market. This has happened in our International Portfolio even though soaring gold mining stocks and the sharp falls in other commodities helped mitigate that underperformance. And yet the fundamentals of those underperforming companies within the International portfolio are improving so much that we have used the disproportionate fall in some of our investments to buy more of them, thus increasing the estimated value of our International portfolio by +4% which, according to our calculations, trades at a FCF yield of 14%. Our estimated value for the Iberian portfolio has remained stable and also offers great potential trading at an FCF yield of 11%.

In fact, many of our portfolio companies trade at valuations that after more than 20 years of experience we have only seen once or twice before (2000 and 2009), and we observe a clear disconnection with the evolution of their fundamentals and their share prices. Therefore, we believe this a historic investment opportunity..

Azvalor News

Team

We welcome Filipe Rosa, who joined Azvalor as Senior Analyst on July 8th. We have known Filipe for almost 15 years. He has more than 20 years' experience as Head of analysis, analyst and fund manager in banks such as Banco Espírito Santo/Haitong or BBVA Asset Management. Filipe has been covering the oil and distribution sector in particular, earning the respect and recognition of all the companies under his umbrella. Filipe, a Portuguese national, also speaks Spanish, English and French, and will work in our Madrid office.

We also welcome Arnaud de Grainville, who joined our investment team on July 22nd. Arnaud has spent the last 6 years working for the Luxembourg management company Preval, where he was responsible for managing the Preval World Winners fund. He has 14 years of professional experience in management and analysis, and was awarded a Citywire AAA rating in 2018. Of French nationality, Arnaud is fluent in Spanish and English, and will develop his work in our Madrid office.

At the end of May, Víctor Moragas left the Azvalor team after two and half years. We thank him for his contribution during his time with us and wish him the best of luck in his future endeavors.

Summer Course in El Escorial

Last July, the second edition of the summer courses organized together with the Complutense University was held in El Escorial with an outstanding success of participation (92 students) and assessment by students, who mostly gave a score of 5 out of 5. I would especially like to thank José Ignacio del Castillo, Javier Ruiz and Alejandro Estebaranz who, along with the great cast of speakers from Azvalor, have contributed substantially to the success of the event. For those readers interested in learning more about what we do, I recommend you to visit our YouTube channel where the videos will be available later this month. I am sure you will enjoy watching them!

Azvalor Managers

In the recent conferences held with our Managers we have seen their great conviction and excitement regarding the potential of the companies in the portfolio, where there have been no major changes. Javier Sáenz de Cenzano, Head of Azvalor Managers, has demonstrated the same conviction by recently increasing his personal investment in the fund. I would also like to inform you that the "clone" version of the fund is now available in Luxembourg.

I would like to conclude this letter by thanking you for again your trust, a sine qua non ingredient to reach the high returns we project for our portfolios in the long term. We are absolutely convinced that they represent a historic investment opportunity and once again we demonstrate it with "skin in the game", increasing our own investment in the funds.

Regards,

Fernando Bernad
Founding Partner and Investments Co Director at Azvalor Asset Management