

10th May 2018

Dear Investor,

The underlying reason for writing a letter to our investors is to discuss our performance and detail our investment outlook. In an ideal world, this letter would be written every five years, in keeping with our minimum investment horizon. However, we believe our Investors should have all the necessary transparency to judge our work and evaluate our evolving viewpoints. It is in this spirit that we formulate this quarterly correspondence, which we hope you will find useful to better understand our firm and our investment process.

Our funds' performance is reflected in the tables below, though the individual return of each Investor depends on the net asset value at which they subscribed:

	Jan-Mar		Jan-Mar
azValor Internacional FI	-4.9%	azValor Iberia FI	-1.2%
MSCI Daily Net TR Europe Euro**	-4.3%	85% IGBMT** /15% PSI 20 TR	-2.8%
Return vs. Index	-0.6%	Return vs. Index	1.6%
<i>** Includes dividends</i>		<i>** Includes dividends</i>	

The first quarter was characterised by volatility and difficult market conditions, particularly in February. As disciples of value investing, however, we evaluate opportunities carefully and thoroughly in anticipation of deploying capital at great entry points when market gyrations create attractive valuations. We believe volatility should be harnessed rather than feared and that such conditions create exploitable dislocations and forced selling. For us, highly volatile market conditions create an embarrassment of riches. This generates excitement within our team as such episodic riots often result in cascading sell orders from those other institutions that conflate volatility with risk.

It is clear then that investing in the stock market is somewhat paradoxical because when we see opportunity, during times of apparent disorder, many other actors find reasons to avoid buying. So, when conditions are most benign and tranquil, as measured by conventional risk metrics, valuations are rich and ensure poor long-term outcomes. azValor conducts deep and differentiated primary research to develop the conviction necessary to invest in a manner which should truly compound client capital by buying when others are most fearful. This message is not lost on our clients whose deep understanding of our process and our shared interests, means that our thinking is aligned.

We are therefore proud to have clients who, in general, do not conflate volatility with risk and who understand that azValor will behave counter cyclically to arbitrage and derive value from the market as the pendulum swings from hubris to humility. We understand that these swings may lead to occasional periods of tepid performance, but the long-term outcome of this disciplined strategy is designed to provide more

positive outcomes. Even in the short term, the performance of both funds has improved since the end of Q1 to the time of publication so we maintain our faith in our approach.

The support we have of clients compels us to examine two core tenets:

Firstly, reaching the highest level of honesty that can be demanded from an asset management professional comes down to:

- (i) An alignment of interests - *We invest our own financial assets in the same products as you*
- (ii) We grow our business carefully and methodically in a manner that optimises returns over asset size - *We are committed to closing our funds when we reach EUR 2.5bn*

Secondly, as honesty without ability in this business is not enough, your trust in us compels us to continue to work hard and to enhance our capabilities. This translates into rigorous analysis, business trips and hundreds of conferences throughout the year by all levels of the investment team.

We also seek to enhance our capabilities by investing in the training of the analyst team and by hiring complementary capabilities to our own. Even though azValor stands in good stead among the fraternity of value investors, we see ourselves as managers who choose to work conscientiously and look for people who are smarter than us to join our team and complement our skills.

The Iberian Portfolio

During the first quarter of the year, the Iberian portfolio delivered a negative absolute performance of 1.2%, slightly better than its benchmark, which lost 2.8%. To date, however, azValor Iberia has already increased by 4.6% so far this year, outperforming its benchmark.

As always, we have taken advantage of this in the quarter to partly sell (**Mota**, **Técnicas Reunidas**, **Jerónimo Martins**) and completely sell (**Mas Móvil**, **Viscofan**, **Semapa**) companies whose share price had increased significantly; and to buy new companies (**Codere**, **OHL** and **Prisa**) or others which were already in our portfolio (**Almirall**, **Acerinox**) with more attractive share prices.

We consider all three new purchases to be special situations. In the case of **OHL**, it is the first time that we buy after 20 years of following the company. We did so in the days following a plunge of over 30%. After the sale of the concessions business the group had more net cash than market value. An extremely sceptical market thus "gave away for free" the construction business of the group. We are familiar with the most cynical theses regarding the company and we do not seek to completely refute them. We believe, however, that some parts of the construction business (Spain, parts of the USA) clearly have value while others are endowed with optionality (Latam, EE), so the

penalty from the market may well have been excessive. OHL is undergoing changes in its management, and given the complexity of the construction business, we have limited the investment to 2% of the fund our exposure to the group.

In the case of **Codere** we have taken advantage of the modest following of the company by the investment community to obtain assets of quality in attractive geographical areas at a very reasonable price.

We invested in **Prisa** following the capital increase, once the financial risk had reduced significantly and attracted by the fantastic business of Santillana, which enjoys exposure to Brazil, which is just starting a positive economic cycle after years of severe recession.

In total, we have managed to slightly increase the estimated value of the Iberian portfolio up to EUR 205 per stake, which suggests a potential of 46%.

The International Portfolio

During the first quarter of the year, the international portfolio lost 5% - slightly more than its benchmark. To date, however, and after a very positive recent performance, azValor Internacional is up by 5.1% so far this year, comfortably outperforming its benchmark.

As pointed out in our previous quarterly letters ([4Q 2017](#)) we continue to believe that our portfolio is significantly cheaper than the indices and that the companies comprising it will have a very good returns going forward. The market seems to have started to reflect this, but there is still a long way to go.

At the company level, the most relevant event was the volatility of the month of February, where we were fortunate that two material positions of ours, **Shutterfly** and **Trip Advisor**, surged amid the sharp falls of the overall market. We took advantage of this to sell them at good prices and reinvest in other companies such as **Ensco**, **Transocean**, **Diamond Offshore** and **Hudson's Bay**, which were all bought at very attractive prices with a long-term vision.

The portfolio is still very concentrated: we are invested in 38 companies and the top 15 positions add up to 74% of the portfolio. Some people describe us as "the commodities fund" and, indeed, we have exposure to this sector. However, we see ourselves as an "asset manager that buys cheap stocks", even if this now means overweighting commodities. In fact, given that exposure to the sector is high, we believe that the right way of understanding our portfolio is not by categorizing it by sector but rather understanding it as a series of very discrete situations that each present a fabulous investment opportunity.

We believe that Buenaventura or Grupo Mexico, for instance, have much more potential than **Antofagasta** if the price of copper remains high. Last week we saw our company **Consol Energy**, exposed to US coal, climb by 25%, while its competitor Arch Coal fell by more than 20% in the same week. Same sector, different results! These

are just two examples, but they are key to understanding the idiosyncratic nature of the portfolio.

Anyone who believes the categorization of azValor Internacional as a commodities fund will not be able to explain why our chosen coal stock goes up when other large coal companies go down. Their sectoral categorizations suggest that our alpha is zero and that the downside of some stocks in the sector cancels out the upside in other stocks. But in our view this concept is wrong and it belies the very essence of value investing and the 'bottom up' approach we take to researching and identifying value in individual stocks. Yes, we appreciate that Grupo Mexico will not prosper if copper prices plummet, and Cameco will not rise if uranium prices plunge, but we seek to look beyond conventional wisdom and ask which of these ships – sailing on the same sea - can sail further with the least possible risk.

This narrative is may appear controversial to some and it is right to raise questions of its validity but let's look at the following table which highlights the highest increase and the largest declines for each sector in the last two years as this showcases the 'return dispersion' we aim to exploit. We believe, this dispersion should continue if lowly correlated market conditions continue to couple with higher volatility.

SECTOR	BEST	WORST	DIFFERENCE
Telecommunications	Masmóvil (+470%)	British Telecom (-43%)	513%
Oil & Gas	Neste Oyj (+141%)	Petrofac (-42%)	183%
Commodities	Anglo American (+175%)	Outokumpu (-31%)	206%
Banks	HSBC (+85%)	Banco Popular (-100%)	185%
Construction	Sika (+94%)	Boskalis (-23%)	117%
Leisure	Lufthansa (+93%)	Greene King (-39%)	132%
Automobiles	Fiat Chrysler (+184%)	Renault (+11%)	173%

Source: Bloomberg, May 2016 to May 2018, Total return in local currency.

This table is sufficient to warn about the risk of categorizing an investment EXCLUSIVELY based on the sector it belongs to. Clearly, there is a difference between investing in **Mas Móvil** and investing in **British Telecom**, even if they are both "telecoms" (a difference... of 500%!); and there is a difference between investing in **HSBC** and in **Banco Popular**, even if they are both banks.

In short, we believe that rather than "being invested in commodities" we have a portfolio made up of few highly undervalued companies. Our challenge is to ensure that our companies eventually end up on the left column of the table.

The estimated value of the international portfolio has continued to increase and reached EUR 250 per stake, thus suggesting an upside potential of over 100%.

azValor news

During this first quarter we have experienced many important changes at azValor.

Perhaps the most important news is the incorporation of **Javier Sáenz de Cenzano – until now Morningstar's Director of Analysis for EMEA – as head of the new Managers fund**. When the product is ready at the regulatory level, we will all be able to invest in the world's top fund managers, those that have been generating extraordinary returns for many years in areas but who we cannot access due to our limited resources. Javier has been scrutinizing managers for almost 20 years and has the experience and the enthusiasm to carry out this task. We, and others will be able to assist him.

The **London office** is already running at full capacity: in a normal week, at least 15 companies from all over the world visit. As Peter Lynch said, in this business, the more stones you lift, the more chances you have of finding interesting things. Our analyst Jorge Cruz has spent a month there and others will follow his lead in the coming months to broaden their field of action and gain more experience in meeting with companies. This is a crucial initiative for azValor, and I would particularly like to thank the dedication and effort shown by the head of our London Office, Michael Alsalem.

At the end of May, Fernando and I will participate as speakers in the prestigious **London Value Investor Conference**, Europe's most important investment forum that azValor will attend as sole Spanish asset manager invited by the organization.

Guided by our ongoing interest to improve the direct contact with our investors, in a few days, we will launch the initiative '**A Coffee at azValor**'. In order to maintain some suspense, let me just say that our clients will be able to discuss any issues important to them with Fernando and myself, over coffee. Further details will be announced on our website.

Moreover, azValor Asset Management has been invited by the Complutense University of Madrid to direct one of the **summer courses held in the town of El Escorial, Madrid**. This is an excellent opportunity to spread the culture of investment and contact students interested in acquiring knowledge about the best strategies to grow their savings. This course will take place on July 25th, 26th and 27th. Further information will shortly be made available on our website.

Finally, we would like to express our gratitude for your trust. The Investor Relations team will be pleased to answer any questions you may have.

Sincerely,

Álvaro Guzmán de Lázaro
Chief Investment Officer and CEO