

Dear investor,

The underlying reason for writing a letter to our investors is to illustrate the results obtained. In our ideal world, this letter would be written every five years, as this is our minimum investment horizon. However, we believe that our co-investors should have all the necessary information to judge our work. It is in this spirit that we address these quarterly missives.

The results obtained by our funds are reflected in the tables below. The individual return of each investor depends on the net asset value at which they subscribed:

	Jan-June		Jan-June
azValor Internacional FI	4.4%	azValor Iberia FI	-0.9%
MSCI Daily Net TR Europe Euro **	-0.5%	85% IGBMT** / 15% PSI 20 TR	-0.6%
Return vs Index	4.9%	Return vs Index	-0.3%
**Includes dividends		**Includes dividends	

## The Iberian Portfolio

In the first half of the year, the Iberian portfolio has delivered a negative absolute performance of -0.9%, slightly below the -0.6% obtained by the index. This is not the first time, nor will it be the last, that in quarterly periods (or even annual periods), our fund performs worse than its benchmark. What you should expect, as a client of azValor Iberia, is a significantly higher return than the indices over the long term; and we hope to be judged on this basis alone (this is valid as our governing philosophy and is therefore applicable to ALL our funds). Table 1 below shows the historical performance of the portfolio versus the index.

Table 1. - azValor Iberia vs the Index

	2016	2017	Cumulative (2016-2017)
Result azValor Iberia	15.6%	18.9%	38%
Iberian index <sup>(1)</sup>	2.2%	8.7%	11%
Difference:	13.4%	10.2%	26.4%

(1) 85% IGTBM / 15% PSI 20 TR

In two years, we have generated almost 13 percentage points per year more than the market, and far from bragging about it, I must forewarn you that the probability of repeating these results in the next 10 years is close to zero. We will be very pleased if we obtain between 5 and 7 percentage points per year versus the indices in the future.

With regard to the composition of the portfolio, there have been no significant movements in the quarter. The most relevant has been the divestment of Telefónica, after obtaining a return of only 5% (IRR). We still like some assets include their Brazilian assets, but we are less certain about their exposures in other markets.

We also sold Almirall entirely (IRR +34%) and Catalana Occidente (IRR 9.8%), as well as a part of our position in Técnicas Reunidas, after their share price increases. With the proceeds of these sales, we were able to buy more shares of Mota Engil, Jerónimo Martins, NOS, OHL and Tubacex, taking advantage of their sharp falls.

*We remain optimistic about our Iberian portfolio which consists of 24 companies with good prospects and, more importantly, bought at prices that we believe will allow for meaningful revaluation in the medium term. In particular, and after the creation of value of this quarter, we envisage a potential of 63% for azValor Iberia.*

## The International Portfolio

Though in the first quarter of the year the International portfolio lost 5%, the tables have turned by the end of the first half of the year. As of 30th June, the portfolio has returned 4% through the year, outperforming its benchmark, which is slightly negative.

**The patience and serenity demonstrated by our clients** in withstanding these variations, is much appreciated and, this cannot be repeated enough, **represents 50% of our success**. We are unable to anticipate the fluctuations of the stock market (no one has managed to do so consistently) and whoever believes that this is essential to make good investments should not invest their money with us. A client once asked me what we do if we do not know how the markets are going to perform.

Well, here is the answer, dear Gerardo. This is what we do:

1. Firstly, our work is relatively mechanical:

- We collect historical data of a company, for example, how much it sells and how much it earns, although there are many more such examples
- We arrange the data in our own format to facilitate comparability.
- We collect the same historical data of all competing companies.

2. Secondly, it starts to get a little bit more complicated:

- We hypothesize what the historical data reveals.
- We contrast these hypotheses with those of industry experts.
- We try to understand the incentives schemes of the senior managers of the organization, as well as their degree of commitment and honesty.

- We try to visualize how suppliers, clients, employees, competitors, the regulator and, other actors perceive the company.
3. Thirdly, we do the analytical work which is crucial in the end:
- We try to estimate a range of **future profits** of the company that we are very comfortable with in the light of the above.
  - We value the company.
4. And finally, we conduct certain portfolio management tasks:
- We decide whether to buy the company or not.
  - We assign a weight to this company depending on its attractiveness compared to the rest of companies in the portfolio.
5. Without forgetting that once the portfolio is composed...
- We check once a quarter, when results are published, if things are going as planned. We also analyze the results of our competitors. With 70 companies in the portfolio between azValor Internacional and azValor Iberia, and 3-4 competitors per company, this means tabulating 850 to 1.100 quarterly results per year.

**The other 50% of our success depends on whether we get it right or not.** Our analysis department looks like a factory fuming incessantly trying to cover points 1 and 5. But it also resembles, when it addresses points 2 and 4, the workshop of an old watchmaker, holding a magnifying glass and a craft tool, with a steady hand and paying careful attention to each movement.

Not everyone works this way, and perhaps so much thoroughness is neither necessary nor free from flaws. It certainly does not eliminate 100% of mistakes that we will continue to make, with a very high probability, in the future. But it has worked for us for over 20 years and we believe in it. The proof lies in the fact that as employees of azValor, together with our spouses, sons and parents, we are the first clients of the funds, with 65% more assets than the next family group. The intensity of this analytical process is the main reason we are so protective of our intellectual property and we generally avoid talking about the companies that we are buying.

Another consequence of this intensity is that it will also require, with time, analysts who graduate, replacing the blue overalls with the magnifying glass and the craft tool of the watchmaker. Avoid the temptation of applauding Fernando, Michael or myself when the good results come: without a functioning factory there is nothing we can do. On the contrary, thank Javier Campos, Jorge Cruz, Victor Echazarra, Alberto Rodriguez-Fraile, Javier Orduna, Victor Moragas and Will Moller: they work from dawn till dusk and are key in our investment process.

With regard to the companies, **there have been no significant changes in the International portfolio** compared to the first quarter.

Nevertheless, there continues to be an abundance of opportunity as market moves create large and exploitable dislocations in value. Let me share with you an interesting observation that Michael sent us from London on the day of Facebook's crash: all of the world's listed uranium companies (including integrated miners) are worth less than what Facebook lost that day; and this, in spite of producing the raw material of 10% of the world's power, which is, in addition, a clean energy, without the problems of intermittency of wind and solar. Maligned industries tend to suffer from derisory valuations and little investor attention and these are where we are presently channelling much of our analytical effort.

**We believe that the 42 companies that make up the portfolio have an estimated value which is much higher than their current price (we see an upside potential of over 100%). We have acquired them after very sharp falls in their stock prices, while the rest of the market has continued to increase. Although half a year is not enough to make conclusions, the higher return of our portfolio vis-à-vis the indices is starting to show, and we believe this is just the beginning, given the tremendous disparity in valuation (our portfolio is much cheaper than the indices).**

### azValor news

In this first half of the year, nearly **one thousand new clients** have joined azValor's funds. With them, we already total **seventeen thousand and six hundred**. The call center, led by Jorge Santamaria, has answered 5,966 calls during this time. Each one of these calls is important for us because we see 17,600 white doves crossing the sky together, withstanding the sporadic gusts of winds against them... convinced that it is well worth the journey. But there is always one that breaks its leg or hurts its wing; and that is when Jenny, Pilar, Ana or Jorge from the call center come into play, and with the utmost patience, apply ointments and, raising their hands, help it fly again and bid it farewell as it joins the flock. If you ever feel like an "injured dove" or simply "afraid", call them. They will know how to heal you and if they don't they will refer you to the ICU where the team led by Beltrán Parages will await you wearing green scrubs and gloves. It is one thing not to advertise... But we do not want to lose those who have already flown with us! (especially when the portfolio has such high potential as it is the case now).

The Management and Financial team, headed by Sergio Fernández-Pacheco, has **signed its third external audit and the first visit of the Spanish supervisor to our offices without incidents**. Sergio and his team are like that fierce defence which proves to be the key to victory in every World Cup. To win, you must know how to play the game, and in an increasingly regulated business, defective compliance can be lethal.

Our initiative **"A Coffee at azValor"** has been a **resounding success with almost ONE THOUSAND volunteers**. I never thought that so many people would want to have a coffee with Fernando and me. In fact, my estimate was slightly below one third... Liven up your adrenaline by joining the raffle and the team led by Antonio San José will inform you if you have won the draw. We promise a limited-edition souvenir mug, good coffee, and a half-hour talk about anything you want regarding investments.

The summer courses held in El Escorial together with the Complutense University have just finished with an outstanding success of participation: over 70 attending students joined by almost 300 via video streaming. A panel of experienced speakers and the "star" managers Alex Estebaranz, from True Value, Javier Ruiz, from Horos, Alberto Espelosín, from Abante, and Julio López, from Attitude achieved a spectacular performance. I know that although some of our clients are anxious to know the detail of our analysis, for others, what we do is all Greek to them and would surely prefer us to stop writing and get back to work. To the former, I strongly recommend them not to miss this pre-recorded Value Investing celebration which held the public spellbound in El Escorial.

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