

May 8th, 2020

Dear investor,

The tables below show our funds' performance in the first quarter of 2020. The individual return of each investor depends on the net asset value at which the subscription was made:

	Year 2020*		Year 2020*
<b>Azvalor Internacional FI</b>	<b>-27.0%</b>	<b>Azvalor Iberia FI</b>	<b>-31.5%</b>
MSCI Daily Net TR Europe Euro**	-18.9%	85% IGBMT** / 15% PSI 20 TR	-27.4%
Return vs Index	<b>-8.1%</b>	Return vs Index	<b>-4.2%</b>
<small>** Includes dividends</small>	<small>*05/05/2020</small>	<small>** Includes dividends</small>	<small>*05/05/2020</small>

From a longer-term perspective, the tables below show the total returns obtained by our funds since their launch at the end of 2015, compared with their benchmarks:

	ITD*		ITD*
<b>Azvalor Internacional FI</b>	<b>-17.7%</b>	<b>Azvalor Iberia FI</b>	<b>-21.1%</b>
MSCI Daily Net TR Europe Euro**	2.2%	85% IGBMT** / 15% PSI 20 TR	-17.9%
Return vs Index	<b>-19.9%</b>	Return vs Index	<b>-3.2%</b>
<small>** Includes dividends</small>	<small>*11/13/2015</small>	<small>** Includes dividends</small>	<small>*11/13/2015</small>

During this first quarter of 2020 we have seen stock markets crash. From February 19 to March 23, the S&P 500 index plunged 34%, closing at 2.191 points, its worst level since November 2016. **This represents almost four years of performance down the drain in just over one month. This non-linear market dynamic is its essence, but we humans are not used to non-linear thinking.** Understanding this has been key to successfully achieving past performance and, in our opinion, will be key to recovering the backlog we have accumulated over the last four years.

As with previous falls, we have been bombarded from every direction by explosive waves of information, but perhaps even more in this case, as this pandemic has impacted all life aspects, we still know little about it and it has been reported minute-by-minute by social networks (something that did not happen during 9/11). When fear and excessive news are combined, the signal-to-noise ratio of the information we receive decreases. If extracting the valuable part of any news we receive (signal) is already difficult, it proves to be still more complex and practically impossible today to separate the signal from the noise.

**As money managers, our role is precisely to extract the signal from the noise to protect your investments.** We therefore have to consider two issues - one tactical and one strategic.

**At the tactical level, periods of sharp falls are nothing new and they have proved never to be a good time to sell.** We don't know more than you do about what might happen next month, or even next year, and we don't think anyone else does. This may seem to be bad news but in reality you don't need to know to invest wisely.

At the strategic level, the return of a portfolio in the medium term is governed by the starting level of valuations. If valuations are high, future returns will be poor no matter how good the companies are. And if valuations are low, returns will be good on an aggregate level. **This is not only a powerful anchor when managing assets with a view to increasing them in the medium term, it is the only anchor.**

If we look at a theoretical example – the lowest-risk asset in the most widely accepted currency today - the long-term US Treasury bond - the return it offers is 1% while the Fed's inflation target is 2%. Therefore, anyone looking for safety in fixed income will find themselves with a guaranteed annual loss of 1% in their purchasing power. This is not an attractive alternative. Stock market indices have rebounded sharply from lows (encouraged by the stimulus programs announced) and remain close to their highest valuation levels in history, and this is despite the unfavorable economic outlook.

**Our portfolio maintains a very strong bias towards commodity-producing companies. Their common denominator is that they trade at attractive valuations,** which is key. But they also present many other opportunities. Let's take a closer look.

Our investments in gold mining companies have outperformed the market, with returns ranging between 40% and 100% over this last year, while our investments in oil-producing companies have underperformed the market with average falls of 50%. Our investments in copper and uranium mining companies are at levels similar to those reported a year ago. *It is therefore not true that commodities are a uniform category, beyond this common denominator, the most important one is that all have very a attractive starting price.*

**The magnitude of the current opportunity for our portfolio compared with other investment opportunities is, in our opinion, the greatest we have witnessed in 23 years.** That is not to say that our portfolio is the cheapest it has been in absolute terms, but rather it offers the biggest upside potential compared to other options.

In 1998 or 2008, it was perhaps as cheap, or even cheaper, than it is today. However, in 1998 there were many very cheap options, such as "old economy" companies, as well as bonds that still offered positive real returns. In 2008, practically the entire stock market was cheap. Today, bonds are very expensive, as is the real estate sector, while the main stock indices are still at unattractive valuations even after the April rebound. Although we are starting to find some occasional opportunities outside the indices - in more traditional companies (non-commodity producers) - we believe that undervaluation levels are generally not yet as attractive.

**These tactical and strategic considerations are our roadmap and we believe it is the best one to successfully navigate any future market environment.**

**The most difficult part of obtaining the expected returns has to do with investors' attitude as they must be able to withstand market shocks.** This is always difficult. Historically, we have found that it is even more difficult when you invest with debt (for obvious reasons, since the creditor can ask for a repayment at the worst possible time) or when it becomes psychologically impossible because you have invested money which you will need in the short term. At Azvalor we have always recommended avoiding both situations.

The following simile might help describe it more vividly for investors. Imagine your next-door neighbor, with a house exactly like yours, offers you every morning a price to buy your house, and

a price at which you can buy his. Now imagine that this price fluctuates every day, and that over the course of a year it varies by as much as 50% from maximum to minimum.

This should not be a problem for anyone, as your neighbor is giving you a choice. And you can exercise it when you consider it appropriate, either buying his house when he offers it for 100 thousand euros, or selling him yours when the price is 150 thousand euros. This is exactly what happens in the market. Let's take an example.

Our "neighbor" (the market) was offering us Barrick Gold shares below \$12 in May 2019. It seemed interesting to buy at that price. Only a few months later, in September 2019, he offered the same shares for \$19.5, more than 50% above their price just four months before. And five months later, in early March 2020, he raised his offer slightly to \$21.

But in only 20 days he changed his mind again and on March 20th he was only asking for \$15, i.e. 30% less than just a month before. Many thought "there was something wrong with Barrick Gold". Actually, there wasn't. One month later, on April 20th, his mood swung again and he asked for \$27 for those same shares, almost double the price of March 20th! Barrick Gold is a liquid stock that moves almost \$600mn every day. Therefore, these movements are not amplified by low liquidity.

Another "neighbor" offered \$110 for the American oil company Chevron on February 20th and only \$50 (a 55% drop) one month later, on the 19<sup>th</sup> March. But just over a month after that, in early May, he was already offering \$90 (an 80% increase). Chevron is a company in which \$1.5bn are traded daily.

No neighbor is so crazy as to offer this kind of price day after day and yet the market does it all the time. The perverse effect is that precisely because stocks are liquid and you can get in or out by pressing a simple button or making a phone call, **most investors are forced to have an opinion every minute, as stocks fluctuate every minute.** And these fluctuations affect us negatively, generating fear and euphoria alternately. So, the free and fantastic option of our "loony neighbor" becomes a source of anxiety when it is the market that offers us the choice. In general, the majority who succumb to this anxiety tend to buy high (expensive) and sell low (in other words, badly). **Hence, the key is NOT to succumb.**

**In the case of Azvalor, the vast majority of you, clients, have taught us a lesson with your patience, as we have hardly had any redemptions during this market downturn. As a group, you have NOT succumbed to market pressures.**

There are always some more doubtful clients who remind us in adverse moments if "it won't be different this time", adding to the question the memory of our most recent investment error and its possible repetition "in series". Our response to them is always similar: we all make mistakes, simply because we are human; the key is to make few of them, and for those that are made to have as little impact as possible.

Thus, in our gold mining companies we have gained 40% with Agnico, 100% with Barrick, 75% with Newmont... and yet we have lost 65% with New Gold. This loss in New Gold does not overshadow a fantastic AGGREGATE return on our gold mining investments.

Similarly, in our investments in uranium-producing companies, we have gained 10% in Cameco (which weighs 9% of the fund) and lost 30% in Nexgen (which weighs barely 0.5% of the fund), without this tarnishing what is a very good relative return compared to the market (and which we

believe in this case will follow the path of gold mining investments, with very high expected returns).

In our oil investments we have lost 50% on average, yet in some cases losses have exceeded 80%, so the question here is whether we have made a mistake “en masse”.

One of the pillars of our investment process is to focus our efforts on avoiding what is known as Cognitive Dissonance. This occurs when it is too hard to accept reality and we humans deny it because we are not prepared to face its consequences. There are many examples of this in society (we recommend the book “Black Box Thinking” by Matthew Syed). The best example is perhaps how American prosecutors who have sentenced an innocent man to prison refuse to change their minds and accept their mistake when confronted with irrefutable DNA evidence: the convicted man’s DNA does not match the one found at the scene. In the aviation industry, however, errors (in the form of mass accidents) are recorded in the Black Box and help prevent future accidents.

We, as investors, have been trying for years to apply the aviation model: Azvalor’s managers share the black boxes accumulated from all the accidents suffered during their common investment journey, and in their daily work, strive together with a team of 9 other analysts, to try to break their own investment theses based on studies, conversations with those who think differently, etc. Thus, it is almost certain that, as in the case of gold and uranium mining companies, there will be some investments in oil companies where return will be negative, or even very negative. But at the aggregate level, we believe returns will be, as they have generally been over the last 23 years, very positive. You can learn more about our theses on oil by watching our latest investors conference (<https://www.youtube.com/watch?v=IG--fxyabrww>).

Our desire is to help you, our investors, increase your confidence in our management, to keep you from succumbing to market pressures; the team led by Beltrán Parages on a daily basis, and Azvalor’s managers with their quarterly letters and annual conferences, we are all at your disposal to explain in greater detail what we do and share the autopsy of our mistakes and the margin of safety that we believe our valuations provide. Let’s get down to it.

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## International Portfolio

The International portfolio has fallen more than the indices due to its greater exposure to the oil sector. We could leave the analysis of its recent performance just here, but that would be hiding a lot of valuable information.

As we have already mentioned, our gold and uranium mining companies, as well as our “tankers”, (which together account for 40% of the fund) have performed well, while our oil companies (20% of the fund) have hit new historic lows. What is then so valuable about them if the portfolio, in net terms, that has performed worse than the market? Let’s analyze them.

Firstly, we believe that the good performance of gold, uranium and tankers validates our investment theses in these sectors - their fundamentals are very favorable and of a structural

nature. And, more importantly, they started trading at very low valuations and we still calculate a high upside potential.

To illustrate this, we will give you just a few facts: the price of gold and, in general, of gold mining companies, is still below its 2011 highs, while everything that “matters” to gold (money supply, global debt, interest rates, tax policy, etc.) has long since pulverized the level of what until a few years ago was even conceivable; and it seems that we will continue to move forward in this territory. Tanker companies continue to trade at below-average levels, even though they are chartering ships at record prices at a time when the growth of the global fleet is going to be historically low. In the uranium sector, we are witnessing the largest accumulated production cut in a commodity whose demand is essential and practically price inelastic. So far, the price of uranium has rebounded by more than 40% in the last month, but at \$34 per pound it is still far from the historic highs of \$150 (2007), and the \$75 it was trading at before Fukushima.

Secondly, the shock suffered by the oil sector has aggravated the severe crisis that has been a drag on it since the end of 2014 so creating the worst crisis in its history. This has impaired, to a greater or lesser extent, the value of the various investments we have in this sector and has led to the bankruptcy of one (perhaps not the last) of the oil rig companies.

In judging this investment error (while being aware of the risk of entering the sort of sterile Cognitive Dissonance mentioned above) we believe that the conditional probability of incurring a global pandemic that has paralyzed global mobility as well as a price war in a cartel with almost 50 years of history, was probably less than 0.1%.

If the threshold had been lowered and applied to our history, it would not have been exceeded by companies such as Virgin Media or Smurfit Kappa which gave us so many points of net asset value. Nevertheless, we have always limited the aggregate of companies at risk of permanent loss of value to about 6%.

The good news is that this crisis will produce permanent damage to a part of global oil production that is growing at a dizzying rate. Moreover, it will intensify the situation of lack of investment that has been building up for six years, with the subsequent impact on global production. However, the demand shock is temporary, in our opinion, and the gradual reversion towards the mean is highly probable, leading to a situation of relative shortage of crude oil in the medium term. Therefore, although somewhat belatedly, we believe that our scenario has gained in certainty. The stock market discounting is something else and we have seen prices dragged down to abysmal levels with the oil sector index falling 90% (as we witnessed in the past with gold mining companies). In some cases, world leaders with solid balance sheets and businesses have returned to levels of more than 30 years ago and so we have taken advantage to increase the quality and robustness of this part of the portfolio. To illustrate this opportunity, think of Schlumberger, a world leader in services for the oil and gas industry, with a presence in all five continents and which has generated a historical average return on capital employed of more than 30%. The company was worth as much as \$154 billion, and today is worth \$22.8 billion, which is less than three times the profits it generated in 2014.

As we always do in times of volatility, we have focused on creating value with our investments and divestments, while trying to maximize upside potential and quality. During the first quarter, we have reduced or entirely sold Hudson’s Bay, Eurocash, Compañía de Minas Buenaventura, Teranga, Sandstorm, Range Resources and EQT, among others, and we have increased our positions in Schlumberger, National Oilwell Varco, Galp, Maersk Drilling, Mosaic, Suzano, Golar and DHT.

We believe this turnover has generated value. However, the impact of the current crisis has detracted part of this value.

In particular, we have lowered our break-even price estimate for crude oil to \$50 per barrel, from the \$65 we used previously. This scenario may seem overly conservative, since our analysis shows that this price will not be sufficient to supply the market in the long term, but we have preferred to err on the side of caution.

The reduction in our valuation of Compañía de Minas Buenaventura is also noteworthy. The problems encountered at the Orcopampa mine and a revision of the perspectives for the Yanacocha mine have led us to reduce prudently the estimated value.

All in all, we estimate the value of our international fund at €206 per unit, which is 15% less than the €242 we previously estimated. This represents an upside potential of 155% over the market value on the date of writing this letter. In addition, qualitatively, the portfolio is a combination of strong assets, including many companies that are world leaders. Some are experiencing very good times (uranium mining, tankers, gold mining), while others such as oil are at prices that only occur once every 20-30 years. There are hardly any companies left with debt that have a significant weight, and it is the most liquid portfolio we have had since our launch at the end of 2015. This is an important consideration because in the event of another market shock leading to redemptions in our fund industry, the remaining investors would not be affected.

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## Iberian Portfolio

The Iberian portfolio has fallen in line with the Spanish stock market (-30% YTD). The greater weight of the oil sector has been offset by a lower exposure to businesses that are most affected by the impact of the pandemic (especially some types of services); and our businesses have barely 30% exposure to the Spanish economy, which is presumably among the most affected globally.

During the first quarter, the opportunities offered by high volatility have led to a higher turnover rate than usual. Our main acquisitions or increases in positions have been in companies such as Altri, Arcelor Mittal, Aena, Logista, Mapfre, Euskaltel and Bankinter, while our main reductions or sales have been in Ibersol, Zardoya and Acerinox.

Having reviewed the valuation of our companies, a task we have approached with the same filter of prudence as mentioned above when referring to the international portfolio (in general and specifically to the oil sector), we estimate a value of €186, which is 11.5% less than our last estimate. This represents an upside potential of 130%. Although this value is slightly lower than our previous estimate, due to the outbreak of the pandemic, the QUALITY of the portfolio has improved. The crisis has given us the opportunity to invest in companies that we liked but which were too expensive. Hence, businesses with competitive advantages and with hardly any debt currently weigh more than they did at the end of 2019.

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## Co-investor activity

With regard to investor activity, during the first quarter of 2020 we have had slight net outflows from our funds, but also a strong increase in gross subscriptions. And not only gross subscriptions, but also the company's activity, in terms of operations, has remained positive; we have had a very high inflow of new investors and new subscriptions. In fact, during the time we have been in lockdown (since March 13th) the number of new investor registrations and additional subscriptions has increased by 60% compared to the same dates in 2019, setting a new record of operations in a period of eight weeks. We appreciate the trust of the more than 300 new investors who have joined Azvalor's funds during this period adding to our more than 17,000 registered investors. The launch of our 100% digital channel for the registration of new investors has undoubtedly helped facilitate the incorporation of this large number of new clients.

During lockdown, we have been deprived of face-to-face meeting with our co-investors. However, this has not prevented us from keeping regular contact with each of them, a dialogue which is even more necessary in these times of uncertainty and volatility. Having being officially required to close our offices and asked our staff to work from home, we have continued our activity replacing face-to-face meetings with an increase in written communication and phone calls.

In addition, we have launched a new channel of communication, complementary to the existing ones (face-to-face, call center, Azvalor You, Azvalor on Twitter), on the Telegram platform. With this new launch, our purpose is to continue to grow, sharing and disseminating valuable ideas which we hope will also be of interest to our readers.

Finally, we are pleased to announce another novelty. Just like we did with our initiative "A Coffee at Azvalor", we would like to extend the coverage of the specific concerns of our co-investors. To do so, we will gather up the questions that we receive from you and, twice a year, our management team will draft a written document with the answers to all of them, which will then be sent to those who sign up for this service. With this initiative, we are extending to four the forums in which you can make your voice heard: our annual conference at the beginning of the year, the "Coffee at Azvalor" program throughout the year, and these written answers from our managers twice a year (foreseeably in June and December). We hope that it will be of your interest and we look forward to your questions. Our Investor Relations team will inform you of the details of this new procedure.

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## Operations

From the operational point of view, and due to the demands of the pandemic, we should highlight the effort derived from the need of an urgent migration to remote working. The result has been very positive and on March 16th practically all of Azvalor's employees were working from home without significant incidents, including all functions that require interface with administrators, custodians and supervisors. The robustness of our technological platform has allowed us to respond, in this new environment, to the strong increase in the number of operations and new subscriptions that we have processed over the last few weeks. The new functionality, which enables the registration of new investors through a 100% digital process, has undoubtedly been a very useful tool in this situation where the management of physical documentation is more

complicated for many users. Currently, almost 80% of the new registrations are done completely digitally, thus improving the efficiency of the company and reducing operational risk.

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## Conclusions

The results obtained since we launched Azvalor are still far from satisfactory at the aggregate level. We, as the main clients of the funds, are not satisfied either. However, we know that accepting difficult moments is the heart of what we do, and we trust that, as in the past, the low prices paid will be a source of joy.

Going back to the concept of non-linearity with which we started this letter, we may have to wait a few months or a few years, not too many, to reap the fruits of our investments. Our portfolios rest on a time-tested tactical and strategic compass, more attractive than ever starting valuations vis-à-vis the indices, an increasingly strong and committed team of analysts, a culture of transparent communication with our clients, and a robust operations management. In our opinion, the combination of all these elements provides a very solid alternative at a time when the market is particularly difficult to navigate.



**Azvalor Team**