March 18th, 2020

Dear co-investor,

Firstly, I sincerely hope that you, your relatives and friends are coping with the challenging situation we are going through in the best possible manner.

We are certainly living through unusual times, with a level of extreme market volatility that does not necessarily reflect the reality of investment fundamentals. We have spoken to all the Managers in our fund in the last few days, and below we summarize some common points:

1) Regarding the global economic slowdown we are witnessing, some of the businesses in our portfolio will be more affected than others, and at this point it is difficult to assess the magnitude of the impact, as it will depend on the length of the global slowdown. That said, we believe that the potential **impact on companies' earnings and cash flows will be temporary.**

2) In this environment it is important to be **invested in companies with sufficiently robust balance sheets**, so that they can withstand the worst-case scenario of a lasting downturn, even if it is not the most likely one. In general, we hold companies with strong balance sheets; many are trading WAY below the liquidation value of their assets (especially on Donald Smith & Co. and Moerus Capital's portfolios); and the vast majority have a below average financial leverage.

In the words of Amit Wadhwaney, of Moerus Capital:

"We typically buy stocks of companies with depressed valuations. Such valuations may sometimes stem from the company experiencing some level of distress. Because of this, and a long holding period that is normally envisioned (during which it could be subject to further adversity-macroeconomic or otherwise), we require our investee companies to have survivability, stemming from a strong balance sheet, saleable assets, robust business model or other attributes. It is key to remember here that the stocks in the portfolio are, in our opinion, largely already trading at depressed valuations and all have the survivability characteristics, noted above. The combination of these two factors should help mitigate some of the impact from an economic slowdown stemming from the COVID-19 virus."

According to Richard Greenberg of Donald Smith & Co.:

"While there will be a near term impact on earnings, our companies have the financial wherewithal to survive almost any scenario. On a long-term basis, our average holdings, at close to 5x normalized earnings and at a sharp discount to book value, appear very attractively valued."

3) **All the Managers in our fund have experienced very challenging situations in the past** and have the temperament to remain calm and continue to focus their investment process on companies' fundamentals. Nobody knows when the market will exit panic mode, and it is a futile exercise to try to predict a market trough but, interestingly, the Managers **identify this moment as a historical investment opportunity for a long-term investment.** See below this recent quote from Chris Mittleman (Mittleman Brothers):

"After a terrible year of underperformance for Mittleman Brothers' managed accounts in 2008 (-64.3% vs. -37% for the S&P 500), we began 2009 down another 30% from 12/31/08 to the bottom point on 3/9/09. The despondency was surreal, and despite our repeated attempts to explain it as a grotesque mispricing by the markets, we couldn't have looked any dumber than we did at that moment. From 12/31/07 to 03/09/09 we were down 75%, in just over 1 year and 2 months, while the S&P 500 was down 53%. So much for our brand of value investing. And yet we ended 2009 up +151% (+258% from the 3/9/09 low) vs. the S&P 500 +27%.

We did not join the lemmings in their panic selling party back then, and life-changing results ensued as we went up 14.9x from the 3/9/09 low to our interim peak on 8/31/14. So $1,000,000 invested with us on 12/31/07 was reduced to an unthinkable $250,000 by 3/9/09, but was worth $3,722,000 by 8/31/14."

4) Obviously, the past might not repeat itself, but **the valuations of many portfolio companies are in the non-sense field**; as a whole, the Price/Earnings ratio of the portfolio trades at around 8 times. As an example, taking the top holding in the portfolio, Aimia Inc: it has no debt, and **has a net cash balance that is 60% higher than the company's entire market capitalisation.** In addition, it has a customer loyalty services business with stable and cyclically resilient cash flows ($60 million annually versus the company's stock market value of $212 million), has a tax credit to offset future profits, and a new board of directors, which is going to make strategic acquisitions with the cash and improve the executive team. It is a company that has significantly improved its fundamentals in recent weeks and months, and yet has fallen 33% in the last thirty days (as of March 16, 2020). This is just one example of the current irrationality present in the market, which is **penalizing companies across the board, without paying attention to each company's fundamentals**.

5) Manager Goehring & Rozencwajg comments, **in relation to oil dynamics**, that even the deniers of the decline of American shale oil (fracking or hydraulic fracturing), such as the consulting firm Rystad, now recognize a drop in shale oil production of 1-2 million barrels per day. When demand recovers from the impact of Coronavirus (and boosted by the end of the trade war), demand will be growing at more than 2 million barrels per day (year on year growth), in a market that in the last twelve months was at a point close to equilibrium, which means that there will be a deficit of about 4 million barrels per day. Goehring & Rozencwajg believe that it is impossible for Saudi Arabia to increase production to the publicly stated level because, among other things, they have not yet fully recovered from the Abquaiq and Khurais attack a few months back. Thus, **the oil price recovery should be extreme**.

6) We have had some inflows on Azvalor Managers in the last few days, with **investors taking advantage of the price collapse as an entry point for a long-term investment**, including some Azvalor employees and employees' relatives. Azvalor employees as a group are the largest investor in the fund, and rest assured that we will treat the fund as if it were our own capital because, in fact, it is.

If you need more information or would like to access the latest letters from any of the Managers, please contact us.

Thank you for your attention,

Javier Sáenz de Cenzano, CFA