2nd Quarterly Letter to Investors
30/06/2020
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

Performance for the second quarter of 2020 has been +10.2% for the Iberian fund, +13.3% for the European fund and +16.4% for the Microcaps fund.

The pandemic caused by the Covid-19 virus has undoubtedly been the focus of attention around which the health, political and economic news of the first half of the year has revolved.

The negative economic effects of the lockdown measures taken by governments are having an impact of unprecedented magnitude for practically every country. The IMF estimates for 2020 a fall in global GDP of -4.9% and -12.8% in the case of Spain, without a doubt one of the most affected developed economies.

The rebound in the stock markets during the second quarter has been one of the biggest ever in history. The gap between different sectors and investment styles has continued to reach new highs. Specifically, technology, growth, momentum or quality companies have performed much better than the rest of the equities linked to the business cycle generally found within the value category, such as capital goods, industrials, chemicals or energy among others.

In the face of an unprecedented economic and health crisis, adding to that an environment of zero or negative interest rates, investors are willing to pay high prices for those companies that provide a sense of security and promise certain growth in profits, regardless of the fact that high expectations together with high multiples are an almost certain guarantee of poor long-term results.

The main world economic powers, especially the US and Europe, have continued down the path of expansive monetary measures through central banks and fiscal measures taken by governments. The result is a huge amount of money, in the order of trillions of euros and in different formats, in the hands of governments in order to rebuild battered economies following the pandemic.

Although it may seem strange, the behaviour of the stock market during this period has been somewhat ‘normal’. Let’s not forget that the stock market is a leading indicator of the macroeconomic evolution of a country.

Given the first news of the spread of the virus and the subsequent lockdowns, stock markets began with an aggressive bear market in terms of speed and magnitude. This abrupt movement anticipated the reality that we are now experiencing in terms of the destruction of economic growth, as we saw previously in the IMF's estimates.

Since the lows seen in March, the rebound has been very considerable, especially for our portfolios that have recovered around +30%. As we said, behaviour that is considered 'normal'. First, due to the recovery from the excessive punishment suffered during the drop; and secondly, due to the lifting of lockdowns, the gradual return to normal activity and the support financial markets received from central banks and governments themselves.

We believe there are several reasons to remain optimistic for the future:

- Bear markets normally end with the start of a recession. We have had one of the hardest bear markets on record and we are currently in the middle of a deep recession. Let's remember that the stock market discounts expectations, anticipating the bad and the good.
- The real activity data that is being published such as retail sales, confidence indicators and manufacturing activity, car sales in China, steel and copper prices, among others, are performing better than expected. Some data are even showing signs of recovery.
- The existence of an enormous amount of liquidity in the market, as a consequence of expansionary policies, which otherwise would not have occurred had it not been for the coronavirus pandemic.
- Lastly, the possibility of inflation cannot be ruled out, which could lead to some normalization of interest rates and consequent revaluation of assets such as equities.

Thus, our funds have recovered a significant part of their declines, but still reflect a too-negative scenario that does not correspond to the reality of the vast majority of the businesses in our portfolios.

From the constant contact and communication with our companies, and now with a greater degree of evolution of the pandemic, we have been verifying that our estimation of impacts on valuation has turned out to be quite accurate. This is good news.

Consequently, of more than 100 companies that we have spread across the three funds, we can state that there has not been a single company that has had to take any measures in terms of protection against creditors or declare itself bankrupt. Our constant analysis of the companies' financial health has undoubtedly been essential. This does not mean that there have been no significant losses in the intrinsic value of a very limited number of companies, which frankly, will be difficult to fully recover in the future.

Specifically and within the European portfolio, the companies related to oil services have suffered significant cuts to their intrinsic values. This has been particularly severe in the case of **Shelf Drilling** and as we mentioned in our previous quarterly letter, it is one of the most affected by the double effect of the pandemic and the oil crisis.

Shelf Drilling's investment case is explained by the particular capital cycle that the sector was going through in mid-2018, which seemed very favourable to us, due to cuts in investments by oil companies that had brought the capacity utilization close to historical lows, very low prices at the time that made practically all players in the industry lose money and also due to the number of companies that decided to leave the market. Finally, and as a result of the above, orders for new platforms were practically non-existent and older platforms were being scrapped.

We decided to invest in two companies in this sector, **Maersk Drilling** and **Shelf Drilling**, In our judgement the least leveraged and the most secure. Today, many of the sector's competitors have filed for bankruptcy or are in the process of recapitalization. Due to the very low price of crude oil, **Shelf Drilling** has had some contract cancellations, although at the end of the first quarter its order book covered almost the next three years, the highest value in the industry. However, the company is trading at 10% of its book value, discounting an extreme restructuring situation, similar to that of other competitors.

It isn't possible to know what will happen in the future, but you can simulate the impact of things not going as well as expected in your portfolio. At **Shelf Drilling**, unfortunately, things have not turned out as expected and have gone against us in such a way that the new intrinsic value, despite offering a high potential compared to the current price, remains well below our level of entry. It can therefore be marked as an investment error, which at the end of this reporting period has had a cumulative negative impact of -1% on the fund's performance in the last two years.

In terms of the above, we must restate our maxim that the best protection against the possibility of making mistakes, in addition to buying with a wide margin of safety, consists of correct weight allocation. In the case of **Shelf Drilling**, its weight never exceeded 1.25% of the fund.

Something similar has happened to us with **Waberer's** and **MPC Container** in the Microcaps fund, both for allocated weights and for loss of value. Currently, the weight of these two values represents around 1% each.

We have had several conversations with the management team of both companies, and we consider their respective restructuring plan for **Waberer's** and recapitalization plan in the case of **MPC Container** to be reasonable. Due to the strong upside potential for both stocks of approximately +200%, we are maintaining our positions.

In the Iberian fund, despite the strong impacts that the pandemic has had on companies such as **Meliá Hotels** and **Ibersol**, our new target prices are still well above our average entry prices. Therefore, we cannot speak in any way of non-recoverable capital losses in this fund.

With the previous exercise we would like to explain our risk management strategy, focused on the adequate and moderate allocation of portfolio weights in addition to buying with wide margins of safety. For example, if we had a 10% weight in **Shelf Drilling** (justifiable in some ways due to the extremely high upside potential at the time) we would be facing the challenge today of recovering a cumulative loss for the fund of -9.5% compared to -1% that we have effectively suffered. When you think in terms of loss, portfolio management becomes more prudent.

During the pandemic we have had a high level of activity in the portfolios, especially in the moments of biggest declines, increasing weight in those stocks that had a better combination of valuation and financial strength.

In the European fund, we have increased our weight in **Aker BP**, **OCI**, **ArcelorMittal**, **Porsche AG**, **Husqvarna**, **A.P. Moller-Maersk**, **Covestro** and **Signify** among others.

In the Iberian fund, the increases have been mainly in **Inditex**, **Applus**, **FCC** and **Gestamp** among other stocks.

Finally, in the Microcaps fund, **On The Beach Group Plc**, **Sol SpA**, **Recticel**, **Massimo Zanetti** and **Fleury Michon** have been some of the companies in which we have increased our exposure.

In terms of selling there has been little activity. We have not sold any positions; we have only partially or marginally reduced weight in some stocks with good performance during the current crisis, such as **Carrefour**, **Dräger** and **Euronav** in Europe or **Siemens Gamesa** in Iberia. It is important to note that our conviction in these companies, despite having reduced exposure, remains at its maximum.

One of the best indicators of the future returns of an investment is determined by the profitability of free cash flow of a given company (known as FCF yield). This goes with the statement "if a business works, the stock eventually follows ".

Let's think that, for an unlisted company, the profitability that we hope to achieve is determined by the profitability that the business itself generates year on year, measured by free cash flow after paying all relevant expenses. The complexity comes when we enter the world of listed companies, in such a way that said companies' shares fluctuate freely (or crazily?) on a daily basis. There is an interesting relationship between the FCF yield ratio and the evolution of the stock price in the long-term. History shows that the behaviour of these shares tends to converge towards the underlying real profitability of the business's FCF yield as we have previously defined. Therefore, if a company (or fund) has an FCF yield of 8%, we should expect returns close to that figure in the long run. The

American asset manager VERDAD carried out an interesting study of the Japanese market in this respect[1].

The valuation of our three funds is very attractive both in EBITDA multiples below 6x and in terms of profitability in terms of the FCF yield, at levels of 10%, this being therefore a good approximation of what we should expect in future in terms of performance. Likewise, and as another way of looking at it, current upside potentials of more than +100% would be equivalent to returns of +10% per year compounded over the next 7 years, +15% for 5 years or +24% for 3 years.

Our main objective is to manage your wealth, making it grow in the long term. Although we have met this objective during our first five years, I must admit that this year the data are not satisfactory, unfortunately due to the returns on our funds being negative and even below the main benchmarks.

For this reason, I would like to convey my sincere thanks to all of you, our investors, for continuing to trust Magallanes. I honestly believe that the current moment of the funds, as an investment opportunity, is excellent, offering very good future rates of return thanks to its attractive fundamental valuation. Time and patience will pay off. The strategy of buying companies below what they are worth has never stopped working, ever. We see no objective reasons why this should no longer be valid.

A good example of the above is our investment in the German family-owned DIY retail operator **Hornbach** (through the two positions we have in our portfolio **Hornbach Holding** and **Hornbach Baumarkt** with a total weight of more than 4% of the fund). After years of trading at derisory multiples, well below its American peers **Home Depot** and **Lowe's**, the company stands out this year as one of the stocks with the highest revaluation with increases close to +30%. **Hornbach** continues to gain share in its respective markets with unique productivity rates in the DIY sector, achieving growth of around +8.1% like for like; quite an achievement for what is mainly a company with a direct sales format from physical stores. After a few years of large investment to develop its "multi-channel" strategy based on the combination of physical and online store sales, the current crisis due to Covid-19 further reaffirms **Hornbach's** unique model and its competitive advantage over its competitors. In fact, they have managed to achieve a 30% online DIY market share in Germany. Having bought cheap at the time, but especially the fact of having 'held' the position during all this time have been key factors in order to be able to reap the rewards of long-term patience.

It is a source of pride to share with our clients that our Magallanes Iberian Equity fund has recently received the highest qualitative rating of Gold in its institutional class by Morningstar, being the only fund to achieve this within the category of Spanish Equity. In

[1] https://mailchi.mp/verdadcap/asset-allocation-beyond-the-zero-bound?e=7a59cb2ad6

the analyst's own words, "the potential of the Magallanes Iberian Equity derives from a meticulous investment process carried out by its highly experienced manager".

Regarding the current coronavirus health crisis, we want to share with you the initiative approved by our Board of Directors to donate 10% of management fees during the health emergency state to cover the needs of hospitals and medical staff in patient care. First, we started by going to hospitals, with the purchase of beds, monitors, ultrasound scanners, surgical masks and protective overalls. In addition, we contacted **Dräger's** CEO for Europe to bring six invasive respirators to Spain. Our next challenge was nursing homes, with which we collaborated in the purchase of rapid Covid-19 antibody tests and with the distribution of hand sanitisers. And we have also aimed from the beginning to support health personnel and groups that are on the front line, for example, participating in the management, purchase and donation of hand sanitisers, in collaboration with AMEF and the Madrid City Council.

Thank you again for continuing to trust us, in an environment as complicated as the current one, the management of your investments together with ours.

Yours sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

ANNEX. RETURNS BY FUND AND CLASS as of 30/06/2020

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	102,7068	**-1,68%**	**10,03%**	**-28,15%**	**-28,79%**	**-28,15%**	**6,02%**	**-9,22%**	**15,45%**	**15,48%**	**8,04%**	**-0,40%**	96,7%
Iberian benchmark		2,40%	8,28%	-21,27%	-17,63%	**-21,27%**	15,38%	-11,59%	12,13%	0,52%	-5,73%	-14,46%	
Magallanes Iberian Equity FI "P"	105,5186	**-1,64%**	**10,17%**	**-27,97%**	**-28,44%**	**-27,97%**	**6,55%**	**-8,76%**	**16,03%**	**16,09%**	**6,32%**	**0,28%**	96,7%
Iberian benchmark		2,40%	8,28%	-21,27%	-17,63%	**-21,27%**	15,38%	-11,59%	12,13%	0,52%	-11,27%	-19,67%	
Magallanes Iberian Equity FI "E"	109,9179	**-1,58%**	**10,38%**	**-27,70%**	**-27,90%**	**-27,70%**	**7,35%**	**-8,07%**	**16,91%**	**16,91%**	**12,72%**	**9,92%**	96,7%
Iberian benchmark		2,40%	8,28%	-21,27%	-17,63%	**-21,27%**	15,38%	-11,59%	12,13%	0,52%	2,57%	-6,66%	

[1] *Class M 29/01/2015; Class P 26/02/2015; Class E 09/01/2015. Returns net of fees. Iberian benchmark: 80% Ibex35 Net TR + 20% PSI20 Net TR.*

MAGALLANES VALUE INVESTORS UCITS IBERIAN EQUITY

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	91,2652	**-2,02%**	**9,59%**	**-28,45%**	**-29,23%**	**-28,45%**	**5,68%**	**-9,61%**	**14,79%**	**16,33%**	**-**	**-8,73%**	98,3%
Iberian benchmark		2,40%	8,28%	-21,27%	-17,63%	**-21,27%**	15,38%	-11,59%	12,13%	0,52%	-	-10,43%	
Magallanes Iberian Equity Lux "I"	93,4666	**-1,98%**	**9,72%**	**-28,27%**	**-28,87%**	**-28,27%**	**6,21%**	**-9,14%**	**15,42%**	**16,99%**	**-**	**-6,53%**	98,3%
Iberian benchmark		2,40%	8,28%	-21,27%	-17,63%	**-21,27%**	15,38%	-11,59%	12,13%	0,52%	-	-10,43%	

[1] *Class R 31/12/2015; Class I 31/12/2015. Returns net of fees. Iberian benchmark: 80% Ibex35 Net TR + 20% PSI20 Net TR.*

MAGALLANES EUROPEAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity FI "M"	105,2629	**4,72%**	**13,14%**	**-22,89%**	**-21,18%**	**-22,89%**	**21,48%**	**-19,19%**	**19,52%**	**12,89%**	**3,47%**	**5,68%**	97,6%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	2,58%	0,42%	11,58%	
Magallanes European Equity FI "P"	108,1814	**4,77%**	**13,28%**	**-22,70%**	**-20,78%**	**-22,70%**	**22,09%**	**-18,78%**	**20,12%**	**13,45%**	**4,23%**	**8,87%**	97,6%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	2,58%	0,43%	11,59%	
Magallanes European Equity FI "E"	112,6758	**4,83%**	**13,49%**	**-22,41%**	**-20,18%**	**-22,41%**	**23,01%**	**-18,17%**	**21,02%**	**14,31%**	**4,29%**	**12,68%**	97,6%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	2,58%	9,77%	21,97%	

[1] *Class M 27/01/2015; Class P 29/01/2015; Class E 09/01/2015. Returns net of fees. European benchmark: MSCI Europe Net TR.*

MAGALLANES VALUE INVESTORS UCITS EUROPEAN EQUITY

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	99,1799	**4,64%**	**13,02%**	**-23,13%**	**-21,62%**	**-23,13%**	**20,89%**	**-19,43%**	**19,11%**	**18,30%**	**-**	**5,50%**	98,9%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	9,39%	-	18,49%	
Magallanes European Equity Lux "I"	101,5201	**4,69%**	**13,16%**	**-22,94%**	**-21,23%**	**-22,94%**	**21,50%**	**-19,00%**	**19,76%**	**27,76%**	**-**	**16,04%**	98,9%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	19,66%	-	29,62%	
Magallanes European Equity Lux "P"	103,1088	**4,72%**	**13,27%**	**-22,79%**	**-20,92%**	**-22,79%**	**21,96%**	**-18,70%**	**20,16%**	**12,08%**	**-**	**3,11%**	98,9%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	10,24%	2,58%	-	11,11%	
Magallanes European Equity Lux "ING"	75,9700	**5,76%**	**16,25%**	**-17,32%**	**-19,95%**	**-17,32%**	**14,72%**	**-19,91%**	**-**	**-**	**-**	**-24,03%**	98,9%
European benchmark		3,07%	12,60%	-12,84%	-5,48%	**-12,84%**	26,05%	-10,57%	-	-	-	-3,92%	

[1] *Class R 29/01/2016; Class I 12/02/2016; Class P 31/12/2015; Class ING 17/01/2018. Returns net of fees. European benchmark: MSCI Europe Net TR.*

MAGALLANES MICROCAPS EUROPE, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2020	2019	2018	2017 [1]	2016	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	76,2694	**2,02%**	**16,40%**	**-21,34%**	**-17,12%**	**-21,34%**	**10,59%**	**-21,98%**	**12,37%**	**-**	**-**	**-23,73%**	92,9%
European benchmark		2,60%	23,19%	-11,77%	-3,03%	**-11,77%**	22,39%	-13,38%	8,14%	-	-	1,15%	
Magallanes Microcaps Europe, FI "C"	75,4113	**2,00%**	**16,29%**	**-21,54%**	**-17,62%**	**-21,54%**	**10,10%**	**-22,18%**	**7,81%**	**-**	**-**	**-27,52%**	92,9%
European benchmark		2,60%	23,19%	-11,77%	-3,03%	**-11,77%**	22,39%	-13,38%	7,22%	-	-	0,28%	

[1] *Class B 17/03/2017; Class C 31/03/2017. Returns net of fees. European benchmark: MSCI Europe Micro Cap Net Total Return.*