Quarterly Letter to Investors
30/06/2017
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

The performance of our funds in the first half of the year was +12.87% for the Iberian strategy and +12.17% for the European strategy. Since inception, more than two years ago, the funds total return was +49.30% and +34.20%, respectively[1].

Emmanuel Macron presidential election in France and oil prices falling below $50 were the two most important events during the second quarter of the year. Stock markets continued their positive momentum with the main US indexes reaching new all-time highs.

During this period, we had a notable increase in the number of transactions in our funds. The typical rotation of our portfolios, defined as the total size of buy and sell orders as the percentage of total AUMs, is low, typically under 20% and in line with our five-year average holding period for every investment. According with our investment process, it makes sense that after almost three years some of our investments reach their optimal stage and are replaced by new incorporations in our portfolios.

The majority of the transactions was executed at the end of the second quarter and continued during the month of July. We pretend to detail the relevant changes of the portfolios in our third quarter letter.

In our recently incorporated companies you will find interesting novelties, which continue to meet the typical characteristics of a "Magallanes style" investment: cheap and out of favour companies trading, many of them, at multiyear lows.

Cheese, butter, boats, fertilizers and cars, it's all the same. Allow me to elaborate this sentence in a few paragraphs. After almost two decades in investment world I can't stop being surprised by the pendulum-like behavior of financial markets. The speed the market changes from greed to fear and from fear to greed without stopping, even for a few seconds, in the equilibrium position is absolutely astonishing.

Coming back to butter. Recently we read the following headline in the Financial Times: "Why butter prices are at a record high?". As you know, one of our biggest positions in the European fund is the French milk processing company Savencia, one of the global leaders in the production and distribution of cheese, butter and other dairy products. Just one year ago, in the second quarter letter of 2016, we detailed our investment case in

[1]Iberian strategy: Magallanes Iberian Equity P. European strategy: Magallanes European Equity P. At the end of the Letter you will find an Annex with a detailed performance for each and every investment vehicle and fund class managed and/or advised by Magallanes. Performance since inception corresponds to class E as for being the first active class on 09/01/2015.

the company. At that time, butter prices, and other milk sub products as cheese, were not at their highs, quite the opposite, they were at historical lows. Here we present part of our internal research note of Savencia, written at the start of 2016:

- *Our investment case in Savencia is based on the milk price cycle, which in turn represents also its biggest risk:*
  - *During the year of 1984, the UE established a new system of quotas for milk production due to the oversupply situation of the market. In March 2015, the above-mentioned system was ended after the milk supply was normalized due to the reduction of number of milk farms and above all by the increase of milk exports to new markets outside the UE, especially Russia and China. During the period 2010-15, the export growth was impressive with volumes and value increasing 45% and 95% respectively. Value added products like cheese led the exports.*
  - *The end of the quotas system in Europe liberalized milk production. Each farmer was now allowed to produce all the desired milk without any restriction.*
  - *What looked like a "soft landing" turned out to be a catastrophe for the sector. The end of the quotas systems, the Russian embargo to European products and the slowing demand from China led to one of biggest corrections in the milk sector, with prices falling 40% from 2014 highs to the lowest point in 13 years. The global overcapacity was especially worrying in Europe, where in 2015 it reached 5 mn tons.*
  - *The price fall in the last quarters was so impresive that for many farmers the production cost is now above the market prices. We think this fact will lead to a reduction of milk supply in the next months/quarters which will impact positively global milk prices. The price recovery could be faster if Russia and China milk demand improves in the next months.*

April 2016, Magallanes Value Investors

One year has passed and now the scenario is quite the opposite. We can read in the FT article that due to the difficult situation in 2014 and 2015 many farmers decided to abandon milk production. Also, China and Russia milk imports started to recover. The result is simple, less supply and increasing demand ends up in increased prices. Savencia and other dairy product players are the clear winners of the current environment with increasing margins and profitability for their businesses. When we first bought Savencia nobody wanted to invest or even to look at milk and dairy products. Today, and after a +50% rally, is seems the interest in the sector is coming back.

Savencia's investment case was the typical temporary imbalance between supply and demand. Looking at this and other examples we can conclude that in real life the supply and demand charts don't behave as we learned in University, at least the supply side.

The demand is a straight and continuous line between price and volume, where each rational consumer (from the millions and millions around the world) is willing to buy more for a cheaper price. In contrast, the supply side is formed by less and more heterogenous agents that are always willing to sell more at a higher price. There is a limit of products that can be offered independently of the price: the supply of almost every product is limited because the resources are also limited. As much as we like butter and even if we are prepared to pay its price in gold it would not be possible, in the current conditions, to buy all the butter we would like. It's impossible, in a short period of time, to buy the land, build a farm, buy the cows, buy all the machinery needed, get all the licenses and start producing and selling butter. It takes time.

The current high prices encourage new investments and capacity increases, many entrepreneurs and businessmen are attracted by the current market conditions and decide to start their new project today. But when the new supply reaches the market, it immediately starts affecting market prices if the demand has not evolved as it was expected when the investment was decided. This situation can turn to a disaster if all these new projects are financed with debt.

The previous example is the classical definition of the capital cycle: high prices in profitable businesses will attract new competitors aiming for the same high profitability, which sooner or later, will end in excess capacity which will negatively impact prices until some producers start to close capacity. The companies with the more leveraged financial structures or with less efficient industrial processes will be the first to exit the market. This capacity destruction will lead to a new market equilibrium. Each industry has its own capital cycle and these cycles can be sometimes uncorrelated with the global economic cycle.

In fact, this situation has not only happened in the dairy products but also, in our view, in other different sectors like the shipping industry, fertilizers and car producers.

In respect with the shipping industry, we have found very interesting ideas in the niche segment of the refined products transportation, also known in the industry as product tankers. In contrast with the typical crude carriers, known as crude tankers, which transport oil from the oil fields to the refineries around the world, the product tankers transport refined products as gasoline, diesel and other distilled products directly to the end consumption point.

Our expertise in the shipping industry is broad and goes back to more than two years ago, when we first bought, and subsequently sold, the Norwegian company BW Offshore, the world leader in the construction and operation of FPSOs.

The shipping industry sector enjoyed a very positive operating environment between 2004-08, a moment that was even labelled as a supercycle. The commodities rally, the structural growth of global trading and the easing financing conditions at the time fueled one of the biggest bubbles in recent history, similar to the real estate bubble in some countries like Spain. At that time, the daily rates to rent a ship, main KPI in the shipping industry, reached all-time highs and the profitability of an average transportation vessel was high double digit.

The end game was an unprecedent increase in new vessels orders, which resulted in new investments in shipyards in order to accommodate all the increasing demand. The upsurge momentum of this cycle was so huge, that in mid-2007 the new vessels orders in respect to the global fleet at that time reached almost 50%.

It takes a few years since a new vessel order is placed and the time the vessel is effectively delivered. So, all this capacity that was ordered in the euphoria, reached the market years later and at the same time, matching a difficult period for the sector, which produced a sharp fall in the daily rates and the subsequent collapse of this industry.

Now, ten years later, the shipping industry in general, and the product tankers in particular, finds itself in the opposite situation. The number of shipyards has been reduced to almost half, the banks are no longer happily financing the sector and the number of bankruptcies has skyrocketed, being the Chinese giant Hanji the most recent victim. The sentiment in the sector is so depressed that the new orders in respect to the global fleet is less than 15%, one of the lowest points in recent history.

This worrying situation can even get worse with the new environment requirements for the industry, ballast water treatment systems and the sulfur emission regulation, which will become mandatory in September 2017 and at the start of 2020 respectively. This will increase the scrapping of older and less efficient vessels where the required regulatory investments are not economically feasible.

From all the shipping industry subsectors, the niche market of the product tankers is the one where we find the most interesting ideas and where the dynamics of supply and demand are more attractive at the moment. Specifically, the new orders in respect to the global fleet is at historical lows at 4.3%, significantly below the normal replacement ratio of the sector.

In that sense, we have bought for our portfolio the biggest operator of product tankers in the world, Scorpio Tankers. This Monaco-based company has a total of 124 ships, owned and operated, and trades in the US where there is an historical tradition of listed shipping companies.

The biggest competitive advantage of Scorpio Tankers is the average life of its vessels, currently under two years old, especially after the acquisition of the financially distressed Navig8 (27 vessels with an average life below one year). It has the biggest and the youngest fleet of product tankers in the world and they are perfectly prepared for the new environmental regulatory requirements. At the current price, Scorpio Tankers under our very prudent and conservative valuation of its fleet, is trading at a significant discount to its liquidation value. It has a strong balance sheet where the total debt is less than 60% the market value of its vessels, which for the sector is a conservative figure, and will allow the company to continue to operate for a longer period than its leveraged competitors if the current depressed operating environment persists.

Something similar has happened in the fertilizer industry, where we have bought Potash Corp., the world leader in the production of Potash with a 22% market share. The company also produces Nitrogen and Phosphates with 2% and 3% global market shares, respectively.

Ten years ago, the investment community was afraid we would get a food shortage to supply the unstoppable growth of global population, especially in India and China. As a consequence, the price of all basic commodities such as wheat, corn and soy reached all-time highs. New players entered the agriculture sector attracted by the high prices at that time, and these new investments benefited other agriculture related sectors such as the fertilizers. The request for authorizations and permits for new mining projects of Potash and Phosphate soared as well as the number of plants for Nitrogen production, especially in China. The capital cycle of the fertilizers industry had just started its journey on the highway to hell. The years passed and there was no shortage of food, and that has brought a big correction in all the soft commodities, which also had a negative impact on fertilizers demand and pricing. The situation in the fertilizers sector got even worse with the new projects coming in to the market, depressing the already difficult situation in the industry.

The result today is that the price of Potash and Urea (Nitrogen based fertilizer) are at ten years low. In the case of Urea, the price is so low that, according to Redburn estimates, 60% of the Chinese producers are already losing money. China is by far the world largest exporter and the producer that sets global prices. In China, Urea is produced from coal, a more polluting and expensive production process compared with the natural gas based production from the US players.

The Potash price is currently close to $265/ton, at ten years low, and well below the $400/ton needed to start a new greenfield project. Only the most efficient players and with the soundest balance sheet will benefit from the current overcapacity environment in the fertilizer sector.

Potash Corp. owns some of the most efficient Potash mines in the world, where we would highlight in their portfolio the Rocanville mine that has a capacity to produce up to six million tons of Potash every year with a production cost below $45/ton.

Besides the standalone quality of its assets, Potash Corp. is currently finalizing a merger with Agrium, in which a new vertically integrated global leader in the fertilizer industry will be created under the name Nutrien. This process is the perfect combination between one of the most efficient fertilizer producer and one of the largest agricultural products distribution network in the world.

The European auto industry is also offering unusual attractive opportunities in a context of equity markets close to all-time highs. Possibly, some of the European car producers we've recently analyzed and incorporated in our portfolio are amongst the cheapest value ideas we've found in the last years. In our next quarterly letter we will discuss in detail the sector and the names we're currently investing.

We have been asked many times why haven't we bought banks if our investment philosophy is to look at "the ugliest sectors". It is true the banking sector has been one of the worst sectors in last years, with some important landmarks as was the case with the adoption of the European resolution for Banco Popular. We studied in detail Banco Popular after its latest capital increase at the end of 2016 and at that time we decided not to invest due to the complex situation of its balance sheet. The rest of the Spanish banks, with the exception of the two global ones, are still too difficult to digest. It is very complicated to invest in business models that are by their own nature hugely leveraged, and the investment case gets even worse when we see the investments in government bonds some of these banks have, which in some cases represent several times their own equity.

Magallanes is proud to announce that our fund Magallanes Iberian Equity has been elected as the best equity fund of 2016 in the third edition of the Investments Awards of the Spanish newspaper elEconomista.

Amongst all the events we have participated during the quarter we would highlight our second Investor Day in Madrid, the past 24 of April in the Rafael del Pino Auditorium. It was a great pleasure to present our investment philosophy, our portfolios and discuss other interesting questions we got from the almost 500 investors present. Ending our Investor Day, we had the privilege to assist to one of our advisory board members, Pat Dorsey, presentation on companies' competitive advantages.

In our efforts to promote value investing philosophy we have made available in Magallanes website our personal collection of the 100 essential value investing books for everyone interested.

We've also participated in several international value investing events like the *Morningstar Conference* in Madrid or the *Value Konferenz* in Frankfurt, organized by Acatis.

Magallanes Value Investors has been actively promoting for the development of a liquid and transparent market for microcaps and small capitalization companies. With this in mind, we had the chance to present our ideas for these segments of the market in the latest *MedCap Conference* organized by the Spanish stock exchange, Bolsas y Mercados. We have openly defended a tax credit for retail investors and specific regulation for these segments of the market.

Speaking in the name of all Magallanes team we want to say how honored we are of working for you, our 10.000 investors.

Thank you for trusting us your savings.

Please do not hesitate to contact us through any of the channels available or directly through Mercedes, our Investor Relations representative, for any queries you may have.

Sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

ANNEX 1. STRUCTURE OF THE FUNDS

MAGALLANES IBERIAN EQUITY FI

The fund closes the quarter with an investment level of 84.7% and a total of 27 Spanish and Portuguese companies.

The fund maintains its exposure towards the services and industrial sectors. May we highlight among others stocks like Gas Natural, Semapa, Sonae, ENCE, and NOS. The top ten positions account for 42.1% of the fund.

Spain accounts for 56.4% of the total investment of the fund and Portugal represents the remaining 28.3%.

The prevailing size of the companies in the fund does not exceed a market cap of € 3.0 bn, accounting for 60.9% of the fund. A 23.8% of the fund is invested in companies with market cap of over € 3.0 bn.

Current investment level of the fund seems to be appropriate for us. The number of companies in the fund will not significantly change in the medium term.

MAGALLANES EUROPEAN EQUITY FI

The fund closes the quarter with an investment level of 85.4% and a total of 39 companies.

The fund is biased towards the industrial, manufacturer and consumer sectors. Such sectors are mainly represented through stocks like EON, Bouygues, Orkla, Savencia and Hornbach. The top ten holdings account for 43.4% of the fund.

As a result of the stocks in the fund the exposure to Germany, France and Austria is greater compared to other countries. These three countries represent the 43.4% of the fund.

The prevailing size of the companies in the fund does not exceed a market cap of € 5.0 bn, accounting for 55.4% of the fund. A 30.0% of the fund is invested in companies with market cap of over € 5.0 bn.

Current investment level of the fund seems to be appropriate for us. The number of companies in the fund will not significantly change in the medium term.

ANNEX 2. RETURNS BY FUND AND CLASS as of 30/06/2017

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	144,8450	**-0,10%**	**6,66%**	**12,59%**	**30,84%**	**12,59%**	**15,48%**	**8,04%**	**40,47%**	84,7%
Iberian benchmark		-3,32%	1,93%	13,45%	30,74%	13,45%	0,52%	-5,73%	7,51%	
Magallanes Iberian Equity FI "P"	146,5938	**-0,06%**	**6,79%**	**12,87%**	**31,50%**	**12,87%**	**16,09%**	**6,32%**	**39,32%**	84,7%
Iberian benchmark		-3,32%	1,93%	13,45%	30,74%	13,45%	0,52%	-11,27%	1,19%	
Magallanes Iberian Equity FI "E"	149,3029	**0,01%**	**6,99%**	**13,29%**	**32,49%**	**13,29%**	**16,91%**	**12,72%**	**49,30%**	84,7%
Iberian benchmark		-3,32%	1,93%	13,45%	30,74%	13,45%	0,52%	2,57%	16,96%	

[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 – LUXEMBOURG

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	130,5584	**-0,21%**	**6,60%**	**12,23%**	**29,93%**	**12,23%**	**16,33%**		**30,56%**	84,6%
Iberian benchmark		-3,32%	1,93%	13,45%	30,74%	13,45%	0,52%		14,04%	
Magallanes Iberian Equity Lux "I"	131,6534	**-0,16%**	**6,75%**	**12,53%**	**30,65%**	**12,53%**	**16,99%**		**31,65%**	84,6%
Iberian benchmark		-3,32%	1,93%	13,45%	30,74%	13,45%	0,52%		14,04%	

[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	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity FI "M"	130,1847	**-0,60%**	**5,11%**	**11,89%**	**30,92%**	**11,90%**	**12,89%**	**3,47%**	**30,70%**	85,4%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	2,58%	0,42%	9,89%	
Magallanes European Equity FI "P"	131,7960	**-0,55%**	**5,24%**	**12,17%**	**31,58%**	**12,17%**	**13,45%**	**4,23%**	**32,64%**	85,4%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	2,58%	0,43%	9,90%	
Magallanes European Equity FI "E"	134,2158	**-0,49%**	**5,44%**	**12,59%**	**32,57%**	**12,59%**	**14,31%**	**4,29%**	**34,20%**	85,4%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	2,58%	9,77%	20,12%	

[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 – LUXEMBOURG

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	124,1266	**-0,64%**	**4,96%**	**11,62%**	**28,41%**	**11,62%**	**18,30%**		**32,04%**	85,1%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	9,39%		16,69%	
Magallanes European Equity Lux "I"	125,0999	**-0,60%**	**5,10%**	**11,92%**	**29,11%**	**11,92%**	**27,76%**		**42,99%**	85,1%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	19,66%		27,65%	
Magallanes European Equity Lux "P"	125,6411	**-0,57%**	**5,19%**	**12,10%**	**29,52%**	**12,10%**	**12,08%**		**25,64%**	85,1%
European benchmark		-2,57%	0,86%	6,68%	17,96%	6,68%	2,58%		9,43%	

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

MAGALLANES MICROCAPS EUROPE, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017 [1]	2016	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	109,8075	**0,09%**	**6,44%**			**9,81%**			**9,81%**	85,5%
European benchmark		-0,54%	5,04%			5,37%			5,37%	
Magallanes Microcaps Europe, FI "C"	109,7445	**0,06%**	**-**			**5,48%**			**5,48%**	85,5%
European benchmark		-0,54%	5,04%			4,47%			4,47%	

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