MAGALLANES
VALUE INVESTORS

3rd Quarterly Letter to Investors
30/09/2021
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

Performance in the first nine months of 2021 has been +24.28% for the European fund, +19.63% for the Iberian fund and +36.03% for the Microcaps fund.

The new variants of coronavirus, together with the instability originating from China, have been the main protagonists that have chartered the course of the markets during the beginning of the second half of the year.

A new wave of infections led by the Delta variant brought with it, once again, the reintroduction of lockdown measures as well as movement and travel restrictions, which have temporarily slowed the pace of economic recovery in several of the affected countries.

Fortunately, this situation has been reversed in most countries, as a very high percentage of the population has been vaccinated or has acquired natural immunity, therefore once again seeing restrictions that were initially imposed lifted.

In China, the Chinese Communist Party announced in mid-August a series of measures to "meet people´s ever-growing demands for a good life", with the aim of achieving a "common prosperity for all"[1]. The result has been a strong government offensive against internet platforms and the real estate sector, the setting of strict limits on the number of hours that young people are allowed to spend playing computer games or the prohibition of private schools from teaching compulsory education classes, among other measures. The Hang Seng Index has lost just over -21% from its annual highs as a result of the above, while internet giants such as Alibaba have seen their market value cut by nearly half.

But the issues relating China didn't stop here. There are serious doubts that arose at the end of September about the financial viability of Evergrande, the second largest real estate developer in China, given their difficulties in making interest payments on its large debt, close to 300 billion dollars. The possible contagion effect both inside and outside the country has negatively affected all financial markets around the world.

Despite these facts, the global economic recovery remains strong. For this year, GDP growth is expected in the United States at around +6%, and +5% for the Eurozone, placing the GDP of both economies above pre-pandemic levels.

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1 https://www.ft.com/content/bdcbbdf3-24dd-436d-9e0f-36db2348eadd

This strong recovery in the global economy is accompanied by a significant increase in the prices of main raw materials and energy in particular. Brent crude oil price has risen by +51% so far this year to stand at $78 at the end of the third quarter. On the other hand, and still as a consequence of the disruptions in the production processes due to the pandemic, significant difficulties have appeared in the supply chain in different industries, to such an extent that some regions of the world are beginning to experience serious problems in relation to their energy supply.

In the more than one hundred meetings that we have held with companies during the last quarter, the term “cost inflation” has undoubtedly been one of the most used. This is based, in our opinion, on a structural situation that is difficult to resolve in the short term: the historical underinvestment for years in the traditional manufacturing industry, as well as in commodities producers, has resulted in a limitation of the main production factors. The main consequence is a significant constraint in supply, which is facing strong demand, temporarily parked by the pandemic, but which now returns with a higher level of consumption and investment capacity, also encouraged by the multimillion-dollar fiscal and monetary stimulus plans. In the absence of product, price is the main adjustment factor. In other words, inflation.

In Germany, for example, the latest data points to an inflation rate of +4.1% in September, the highest in the last 29 years. In Spain, the figure was +4%, the highest in 13 years. Although concerned, the rhetoric of the main central banks points to high inflation rates but temporary over time, mainly due to the rebound in energy prices[2].

However, the European Central Bank, reiterating its concern regarding this unfolding inflation, announced the reduction of its debt purchase rate in its special program for the pandemic (PEPP) that now stands at 80 billion euros per month. Along the same lines, the Federal Reserve is considering increasing its reference rate of 0% already for 2022, a year earlier than previously expected. The Central Bank of Norway was the first G10 central bank to raise interest rates, specifically to 0.25% from the previous 0%, indicating another increase, likely for December this year.

Our baseline scenario, based on our fundamental analysis and our conversations with the companies in our portfolio, continues to be that of an economy in a phase of solid economic growth in the coming quarters. Undoubtedly, this represents a benign scenario for the types of companies that make up our portfolios: cyclical industrial companies linked to the reopening of the economy, such as companies in the energy sector, cars, commodities, auto parts, chemical producers, fertilizers, consumer discretionary, transport, leisure, and financials (some banks among those). In short, a typology of companies “leveraged” to the business cycle that hold a certain price setting power, and therefore, a high capacity to increase their profits in an economic situation such as the current one.

[2] https://www.bloomberg.com/news/articles/2021-09-29/powell-says-inflation-spike-won-t-lead-to-new-inflation-regime

The recent setbacks mentioned at the beginning caused by Covid-19 and China have caused a temporary halt in the good stock market performance of these sectors, due to the negative short-term sentiment. The result has been a temporary dissociation between market expectations, affected by these negative events, and the reality, that of an environment of strong economic growth that continues its course.

This divergence has resulted in an "escape" towards different assets considered to be "safe havens" such as technology companies, companies considered as quality stocks, cryptocurrencies, speculative stocks or "meme stocks", companies linked to sustainable investment, renewable energies and bonds, among others. In contrast, industrial stocks linked to economic growth have been the losers. This difference between expectations and reality has generated new investment opportunities in favour of the latter, and predictably, to the detriment of the former.

Delving further into this reality, the results of our companies have been brilliant, with double-digit growth, high cash generation and very promising prospects looking ahead. Additionally, due to their healthy cash generation during these quarters, these companies have strengthened their balance sheets even further. This translates into portfolios trading at around 10x 2022 earnings, a 10% free cash flow yield, as well as a 3% dividend yield and one of the most robust balance sheets ever.

To sum up, the portfolios that forge Magallanes' funds currently constitute an excellent investment opportunity, as well as offering possible protection against inflationary-pressure situations in the present or future, which whether we like it or not, seem more structural than transitory.

All of this, as well as the positive effect on our portfolios due to the combination of a complex environment, inflationary pressures and bottleneck risks, can be seen in various specific investment cases within our portfolios, in addition to the high number of takeover bids, either complete or partial, which we have continued to receive in the last few months.

Thus, the situation regarding China's concern to reduce its greenhouse gas emissions and its commitment to be a "CO2 neutral" economy by 2060 is a prime example. In this regard, it announced a series of measures, including that of reducing the country's steel production, which accounts for about 15% of Chinese emissions[3]. In practical terms, this implies a reduction in the global supply of a material, steel, which is booming on the demand side, in line with the global economic recovery discussed above. The confrontation of strong demand with a restricted supply and minimum inventories is the perfect breeding ground for well-positioned companies such as **ArcelorMittal**, which estimates that global demand for steel will grow by +8% in 2021.

The contrast is striking between its current enterprise market value of 25 billion euros, compared to approximately 16 billion of EBITDA estimated for this year, or in other

3 https://www.ft.com/content/76ef4195-a56b-4647-8aa5-1c8d9a3f08cf

words, a multiple of 1.5x. All this for a company that, if it continues at its current rate of profits, would enter a position of positive net cash during the next few quarters. Finally, and according to our analysis based on replacement value, that is the estimated market value of “building an **ArcelorMittal** from scratch” (with its slightly more than 100 million metric tons of installed capacity), we could be talking about a valuation of about 80 billion, more than 3 times its current market value.

There are more examples. Briefly, **OCI**, a nitrogen-based fertilizer company, is clearly benefiting from the current high natural gas prices (the main raw material to produce nitrogen-based fertilizers), thanks to its advantageous supply contracts, for price and location, compared to the rest of its competitors.

There is more, such as the potential increase in interest rates, that we mentioned at the beginning, will undoubtedly have a positive impact on the financial results of companies in the financial sector, such as banks and insurance companies, which will benefit portfolio positions such as **ING Groep**, **Bankinter**, **Catalana Occidente** or **Vienna Insurance Group**, among others.

The post-pandemic reopening of the economies is having a very positive impact on all those sectors closely linked to travel, tourism and discretionary consumption. Companies such as **easyJet**, **IAG**, **Aena**, **Autogrill** or **Meliá**, are among the big winners of this trend.

Obviously, the increases in energy prices, including both oil and gas, directly benefits those companies that produce them, and those that operate in the sector, such as **Aker BP**, **Repsol** or **Maersk Drilling**.

Even in the case of car manufacturers, the current component shortage environment due to supply bottlenecks, particularly the microchip shortage, is having certain positive collateral effects such as the rise in unitary prices, a phenomenon that hasn’t occurred in the automotive industry for a long time. For example, **Renault** increased prices on its units sold by just over +11% in the first half of the year.

Finally, it’s worth considering the current difficulties in starting certain types of businesses that are mistakenly considered, due to prejudice, ignorance or stereotypes, as “not very environmentally friendly”. The main obstacle resides in the reluctance, or direct prohibition, by public administration when granting permits, which translates into a reduction in the supply of basic products necessary for the correct operation (and progress) of the world economy. **Covestro**’s case is interesting, being a world-leading chemical company in the manufacture of polyurethanes and polycarbonates, by-products without which it would be impossible to manufacture car seats, ski boots, insulation systems for houses, most components used in electronic devices or certain car parts we buy regularly. Similar to the case of **ArcelorMittal**, **Covestro**'s replacement value is well above its current market value.

Similarly, and finally, the number of takeover bids received during the last twelve months is very significant. Specifically, around 20% of the stocks in the funds' portfolios have received some type of purchase offer, either partial or total. It is also interesting that most of these offers come from the management teams themselves, controlling families or industrial insiders who know these companies well. The important message to take from this high percentage, as well as from the type of buyers, is that our companies are trading at very attractive valuations, well below their fundamental value, so much so that those who know them well are willing to pay a premium to gain control of them.

Activity in the third quarter of 2021

Our trading activity carried out during the last quarter has been aimed at strengthening the thesis that shapes our central scenario of economic growth and attractive valuations.

In the European fund, we have increased our exposure in the car manufacturer **Renault**, the bank **ING Groep**, and the airline **easyJet**, taking advantage of the capital increase announced in mid-September, among others. With regards to selling, we have totally sold off our position in **Tarkett** following its takeover bid and we have also reduced our position in **Hella** after also receiving a takeover bid. We have also trimmed positions in **GBL** and **Signify**.

In the Iberian fund, we have bought **IAG**, and increased our weight in **Gestamp**, **Bankinter** and **AENA**. In terms of exits, we have sold our entire position in **Naturgy** after receiving a takeover bid, and we have also reduced our position in **Almirall**.

In the Microcaps fund, we have started a new position in **CIR**, and we have also increased our position in **Ibersol**. On the sales side, we have completely sold our position in **Netia** due to a takeover bid, and partially in **Reno de Medici**, also due to a takeover bid.

Thank you

As always, we are at your service for everything you need in relation to your wealth invested with us, helping you in everything you might need and being available through any of the Magallanes contact channels.

Yours sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

MAGALLANES

VALUE INVESTORS

ANNEX. RETURNS BY FUND AND CLASS as of 30/09/2021

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	3 M	6 M	12 M	2021	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	148,3516	**2,17%**	**5,33%**	**47,01%**	**19,18%**	**-12,92%**	**6,02%**	**-9,22%**	**15,45%**	**15,48%**	**8,04%**	**43,87%**	97,9%
Iberian benchmark		1,86%	5,86%	35,06%	11,59%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-5,73%	7,82%	
Magallanes Iberian Equity FI "P"	153,3693	**2,30%**	**5,59%**	**47,75%**	**19,63%**	**-12,48%**	**6,55%**	**-8,76%**	**16,03%**	**16,09%**	**6,32%**	**45,76%**	97,9%
Iberian benchmark		1,86%	5,86%	35,06%	11,59%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-11,27%	1,26%	
Magallanes Iberian Equity FI "E"	161,2691	**2,50%**	**5,99%**	**48,86%**	**20,30%**	**-11,83%**	**7,35%**	**-8,07%**	**16,91%**	**16,91%**	**12,72%**	**61,27%**	97,9%
Iberian benchmark		1,86%	5,86%	35,06%	11,59%	-11,07%	15,38%	-11,59%	12,13%	0,52%	2,57%	17,66%	

[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 – LUXEMBOURG

FUND	NAV	3 M	6 M	12 M	2021	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	130,2090	**2,02%**	**5,06%**	**45,44%**	**18,61%**	**-13,94%**	**5,68%**	**-9,61%**	**14,79%**	**16,33%**	**-**	**30,21%**	97,4%
Iberian benchmark		1,86%	5,86%	35,06%	11,59%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-	12,90%	
Magallanes Iberian Equity Lux "I"	134,1846	**2,16%**	**5,32%**	**46,17%**	**19,06%**	**-13,51%**	**6,21%**	**-9,14%**	**15,42%**	**16,99%**	**-**	**34,18%**	97,4%
Iberian benchmark		1,86%	5,86%	35,06%	11,59%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-	12,90%	

[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	3 M	6 M	12 M	2021	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity FI "M"	163,4512	**1,49%**	**7,05%**	**44,74%**	**23,81%**	**-3,30%**	**21,48%**	**-19,19%**	**19,52%**	**12,89%**	**3,47%**	**64,10%**	96,0%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	2,58%	0,42%	43,81%	
Magallanes European Equity FI "P"	169,0371	**1,62%**	**7,32%**	**45,47%**	**24,28%**	**-2,81%**	**22,09%**	**-18,78%**	**20,12%**	**13,45%**	**4,23%**	**70,12%**	96,0%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	2,58%	0,43%	43,82%	
Magallanes European Equity FI "E"	177,7183	**1,81%**	**7,73%**	**46,56%**	**24,98%**	**-2,08%**	**23,01%**	**-18,17%**	**21,02%**	**14,31%**	**4,29%**	**77,72%**	96,0%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	2,58%	9,77%	57,20%	

[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	3 M	6 M	12 M	2021	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	153,2105	**1,51%**	**6,90%**	**44,12%**	**23,46%**	**-3,82%**	**20,89%**	**-19,43%**	**19,11%**	**18,30%**	**-**	**62,98%**	97,7%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	9,39%	-	52,71%	
Magallanes European Equity Lux "I"	157,8083	**1,65%**	**7,17%**	**44,84%**	**23,93%**	**-3,33%**	**21,50%**	**-19,00%**	**19,76%**	**27,76%**	**-**	**80,38%**	97,7%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	19,66%	-	67,06%	
Magallanes European Equity Lux "P"	161,0532	**1,74%**	**7,37%**	**45,40%**	**24,28%**	**-2,96%**	**21,96%**	**-18,70%**	**20,16%**	**12,08%**	**-**	**61,05%**	97,7%
European benchmark		0,74%	6,96%	28,76%	16,20%	-3,32%	26,05%	-10,57%	10,24%	2,58%	-	43,21%	
Magallanes European Equity Lux "ING"	111,7100	**1,78%**	**7,70%**	**37,29%**	**19,02%**	**2,15%**	**14,72%**	**-19,91%**	**-**	**-**	**-**	**11,71%**	97,7%
European benchmark		0,86%	7,49%	22,01%	11,59%	2,13%	18,99%	-9,57%	-	-	-	20,27%	

[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	3 M	6 M	12 M	2021	2020	2019	2018	2017 [1]	2016	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	131,0906	**3,09%**	**16,95%**	**59,69%**	**36,03%**	**-0,61%**	**10,59%**	**-21,98%**	**12,37%**	**-**	**-**	**31,09%**	96,4%
European benchmark		0,36%	7,70%	51,13%	22,69%	18,66%	22,39%	-13,38%	8,14%	-	-	66,90%	
Magallanes Microcaps Europe, FI "C"	128,8689	**3,01%**	**16,74%**	**59,07%**	**35,65%**	**-1,16%**	**10,10%**	**-22,18%**	**7,81%**	**-**	**-**	**23,86%**	96,4%
European benchmark		0,36%	7,70%	51,13%	22,69%	18,66%	22,39%	-13,38%	7,22%	-	-	65,47%	

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