Letter from **Francisco García Paramés** to **Cobas' Asset Management** investors (COVID-19)

March 23rd 2020

Dear investor,

We are continuing with the exercise of greater communication started last week and updating the impact of the crisis on our portfolios and **Cobas Asset Management** in general. We will provide these communications as regularly as events require.

At **Cobas AM** we continue to operate without any changes or significant incidents. Despite working from our homes, the intensity is equal to or greater than that of normal times, as this is possible through technology. As you know, we have the great privilege to interact directly with faithful retail clients since the beginning of our story. During the week, 1,335 operations were carried out with clients, with 1,157 (87%) being subscriptions or incoming transfers. Actually, many investors are taking advantage of the opportunity that the market presents us in situations of great uncertainty.

Next, we will go on to analyse the situation of the portfolios. We recall that we work based on estimates or forecasts of future business performance and financial results, and these are based on the expectations of **Cobas AM** and are exposed to factors, risks and circumstances that could affect the financial results, so they may not be achieved.

International Portfolio

During the week we have had phone and videoconference calls with numerous companies. In almost all of these contacts, the estimates we gave last week are confirmed: sales will only be significantly affected in 20% of the portfolio over the coming months.

As for the affected companies discussed last week, the impact on carmanufacturars and retailers is confirmed.

Car sales (6% of the portfolio) are collapsing in Europe, and the key is that the companies have enough liquidity to support a few months with very low sales. **Renault** confirmed that it has 15bn euros of liquidity, between cash and credit availability, and it must be remembered that in 2009 its cash losses were 4bn, so it would seem sufficient. Positively, sales in China are recovering, -45% in the second week of March (they were -80% in February) and for example, **TI Fluid,** a company in which we have a small position (<0.5%) already has its factories in Korea and China operating at 95%.

Dixons (4%) our main retailer, indicated on Tuesday that up until then they had had little impact on sales, but it is logical to think that they will end up having it, given the circumstances, because online sales of electronic devices and household appliances will not offset lost sales in the shops.

At **Aryzta** (6%) we think that the impact may be greater than the "moderate" that we indicated initially, since the closing of restaurants, hotels, etc. do not seem to be offset by the increase in sales in supermarkets.

Our oil extracting companies (3%) will experience lower profits, logically, but have production costs of less than $20, which gives them strength to withstand the current price war.

After talking about the affected companies, we now turn to the remainder. This group of companies, which is the vast majority, tell us that at the moment everything is going according to plan.

LNG infrastructures (25% of the portfolio): We have spoken with **Teekay, Golar** and **Hoegh**. The risk of failure of any of the 100 contracts is very low, and they maintain their results forecast. Remember that although we like the sector, we did not invest in other companies in it, such as **Gaslog** or **Flex**, due to their lack of long-term contracts and their exposure to short-term risks.

Teekay LNG CEO, Mark Kremin, publicly commented on Wednesday that they maintain the profit estimate they have previously communicated to the market, as their 60 ships are working normally, albeit with care so that the crews do not catch the virus. On Friday **TGP** confirmed its dividend of $1, representing a dividend yield of 13% at the current price (and remember that they only distribute 1/3 of dividend profits)

Golar announced this week that the Segipe, Brazil thermal power plant, the largest in Latin America, has passed its testing period and begins operating in the coming days, as well as the LNG import terminal. With this they will begin to enter a minimum of $100 million annually for 20 years. It also announced a new agreement on Monday (16th of March) to establish a terminal in the state of Pernanbuco and distribute LNG in that state.

And in any case, LNG's trading activity continues at a good pace, since gas consumption is fairly stable consumption, with less dependence on economic cycles than other raw materials, such as oil. **ENN**, one of the leaders in gas distribution in China explained on Monday that after demand falling by 5% in January and February in its areas of influence, in March they are recovering and expect growth of 12/15% for the whole year. Remember that 78% of LNG demand in 2019 came from Asia, which appears to have passed the peak of the crisis. In fact, the short-term LNG freight market has improved substantially in the last two weeks (from $35,000 a day to more than $50,000), which has little effect on our companies due to their long-term contracts, but will help improve the short-term sentiment towards the sector. Also towards **Golar**, since a small part of its results is exposed to that market in the short term.

We have also maintained contact with **CIR, Maire Tecnimont, Babcock, Petrofac** and **OCI** (25% of the portfolio). Companies that confirm that they do not expect to have a significant impact on their income in the short term, given the nature of their businesses. Only **Babcock**'s emergency services activity (10/12% of results) is affected by lower volumes. All of them are also changing the way of working to avoid infections.

For **CIR**, **Orpea**'s comments (European leader in nursing homes) on Wednesday are relevant: they maintain the results prospects for the year and are experiencing more interest in their homes, because despite the problems in some, they are safer environments for these people. In **CIR** there have been cases of viruses in their residences, just like in **Orpea**, but at the moment it does not seem that they will have a significant impact.

Finally, the prices that mark the transport of crude oil and derivatives continue to be extremely high ($150,000 vs. $30,000 two weeks ago), which continues to favour our exposure to them (9%), especially in **INSW.**

Therefore, and with the information available today, we maintain expectations in most of the securities.

Iberian portfolio

Reviewing the Iberian portfolio now, it is confirmed that the greatest impact will be on real estate companies (9%) and **Meliá** (4%). Real estate sales may be recovered (it is already happening in March in China), but **Meliá** will not recover the unoccupied rooms over these days. The company is taking drastic measures, such as 50% salary reductions and is facing the situation with reduced debt: the valuation of its hotels is +3.5tn euros and it only has mortgages worth less than 10% of its assets.

Although our exposure to the automobile sector is small, **CIE** and **Gestamp** (2%), the sector is also being affected, as we have indicated.

We have reduced our exposure to the financial sector over these days, as we see too many unknowns for a sector that works structurally with a high degree of indebtedness.

The last sector affected is the media sector (10%), due to the drop in advertising. This impact is real, but it is clear that the value of media content is enhanced during this time of crisis, with the expectation that this will strengthen long-term business models.

In total, therefore, 30% of the portfolio may suffer a clear impact on its short-term sales.

The rest of the main investments in the Iberian portfolio, **Elecnor, Técnicas Reunidas, Semapa, Prosegur, Grupo Sonae, Befesa, Miquel i Costas,** etc. are experiencing little or no impact, taking the necessary security measures to maintain operations.

As a whole in the Iberian portfolio, 85% of the weight is in companies with moderate debt (less than 2x debt/EBIDTA or assigned to a project). In the most indebted, **Quabit**, the most expensive debt is linked to the delivery of homes, partly already pre-sold, although it should not be forgotten that a prolongation of the crisis will have a greater impact.

c o b a s

asset management

Letter from **Francisco García Paramés**
to **Cobas' Asset Management** investors (COVID-19)
March 23rd 2020

Summary

- 20% of the companies in the international portfolio and 30% of the Iberian portfolio are seriously affected by their sales due to the crisis.

- 80% and 70% respectively are experiencing little or no impact.

- We estimate that the permanent loss of value in the funds is small, and all of it derived from the losses that are permanent in their sales (**Meliá**, etc). Remember that a company's value is determined by its ability to generate long-term profits, not by specific situations.

- At **Cobas AM** we continue to operate normally, under the circumstances.

Finally, it should be noted that, in quite a few unjustified cases, the falls in prices, the fact that shares are being repurchased to cancel them means that the damage in the short term is offset by a higher value in the long term. **Teekay LNG** has a $100m share buyback programme, which is obviously more effective with the stock at $8 than at $15. In other words, short-term suffering is compensated by greater long-term value.

These are our best estimates today. Although in some Asian countries it seems that the worst has happened, in Europe and the USA the worst moments have yet to come, so we will be watching events closely.

Best regards,

Francisco García Paramés