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

March 16th 2020

Dear investor,

In these extraordinary times we want to have a more continuous communication than usual, so we will try to keep our entire investor community up to date with the news that concerns us. These are difficult times for all of us, which will pass, but may leave a deep mark on all of us along the way.

First of all, we confirm that at Cobas Asset Management we are working from home and that all procedures are working correctly. Both the registration and cancellation procedures, as well as the daily release of the net asset value and the purchase/sale of securities work properly. We have been in contact with the regulator and, in fact, the customer registration procedure has been temporarily simplified to speed up this process in such troubled times.

Secondly, we are grateful to the reaction of our current and potential customers, as we have had net inflows into the funds both during the month of March (5 million euros) and specifically last Thursday and Friday and this Monday, also with an increase in the number of investors. Obviously this news is very positive because it allows us to maintain optimal portfolio management and continue to take advantage of the opportunities presented to us.

Finally, in terms of the portfolio: we will go into greater depth on the impact of a possible recession on it, and how we are acting. Remember 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 exposed to factors, risks and circumstances that could affect financial results, so they may not be met.

We already said last week that the impact will be small, but there will be an impact. At this time we mainly limit it to:

Automotive sector (7% of the international portfolio)

Sales are going to suffer, with an impact that will be subject to the duration of the crisis. Typically, lost sales will recover over time. Our four companies have net cash, so they will tackle the situation without excessive problems.

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Retail sector (6% of the portfolio)

With the shops closed, sales will be lost. Our main investment is **Dixons** (4%), with the particularity that the United Kingdom has temporarily taken another way of fighting the virus that involves less alteration of customs. It has low debt and a very strong market position.

The aforementioned oil exploration and production companies (3%)

Where the evolution of the price of crude oil will be the decisive factor.

Between 15/20% of the portfolio may see its results affected by a recession. And it must be said that both in the main companies in these sectors, such as **Dixons** or the automobile sector, we were aware of the possible impact of a recession (although not a generalised global crisis), and we had it partially included in our estimates, so that unless the recession is deep and prolonged we will not have to substantially change our assessment in these companies. As soon as we have the elements to judge whether our estimate needs to be lowered, we will report it, but it will be difficult for this impact in the worst-case scenario to exceed 5/10% of our target value, which still allows for strong revaluations.

In the Spanish portfolio, the impact will focus on real estate companies, in **Meliá**, banks and advertising, approximately 25% of the portfolio among them. In **Meliá** unrealised sales will not be recovered, but in the remainder it is logical to believe they will take place in the future.

The impact will last for the duration of the recession in these companies, but in these situations the leading companies strengthen at the expense of the secondary ones. In all probability this will be the case for **Dixons**, for example.

After explaining the negative impact of some stocks, we turn to the positive news. The most important thing to note is that more than 80% of our model portfolio, which is **Cobas Selection,** as of today will not be affected by a possible recession, so a fall in the price only highlights its undervaluation. And this is not accidental, because although it may seem surprising due to the results of the last two years, we have reasonably prepared the portfolio for a time like the present, with investments in very defensive businesses, as we will now see. After 10 years of bull markets what is now happening came within the realms of possibility.

We shall look at the big blocks of the portfolio below

- LNG infrastructure, liquefied natural gas, (25% of the portfolio). The five companies generate their sales through very long-term contracts, more than 10 years on average with a take or pay nature, i.e. you pay me whether I work or not. The essential aspect here is the counterparties in those contracts, and in this case we talk about **BP, Shell, Total, Qatar,** Chinese oil companies, etc. These are all counterparties of the highest quality, although obviously this does not prevent one of the 100 contracts bearing the returns from failing. Five years ago, two contracts failed for **Teekay LNG** because the Yemen war affected the Total plant in the area. It reached an agreement with Total for the contract to start when the war ends and the two ships work in the spot market, with losses being minimal to date. In other words, in order for the expected returns not to be obtained, two things have to happen: a counterparty has to fail and the spot market has to be weak. These two things have a very low probability of occurring together. This allows our companies to work with debt, but all of it in the long term and at a moderate and fixed cost. They are practically the only investments in the portfolio with relevant debt. Let's also remember that the main consumers of LNG are Japan, Korea, China and remaining Asian countries, which seem to have passed through the worst of this crisis without serious consequences for their gas consumption. Growth estimates for LNG in China for 2020 have dropped from 10% to 5/6%, but still with clear growth. Our companies have presented results over recent days (**Dynagas** was the last on Friday), confirming the stable outlook for results. (Curiously, **Teekay LNG** was trading at $1,100m on 1 January and is trading today at $700m; meanwhile it has confirmed that it will have a profit of 250m this year. All five LNG infrastructure companies are listed at PER 3x). The current crisis will not affect its ability to generate profits. No impact on the valuation as a consequence of the crisis.

- **CIR** (8%). Net cash (80% of its market value) and its base business are nursing homes. Stable, growing business that is not affected by recessions. No impact

- Oil transportation (9%). Clear beneficiary of the current price war situation in the sector. Freight rates have risen from $25,000 a day to $200,000 a day today. Its good stock market performance allows us to make profits and invest in companies with large falls. Positive impact (for the time being).

- **Aryzta** (6%). Despite being a company undergoing restructuring, its activity is moderately stable. It may be somewhat affected by a recession (drop in hotels, McDonalds, etc., but rise in supermarkets), but not in the same way as in the ones discussed above. Moderate negative impact.

- **Babcock** (4%). Very long-term contracts in defence activities. At the low of March 2009 it was trading at PER 7x, today at PER 5x. No impact.

- **Maire Tecnimont** (4%). Net cash. Medium-term contracts in petrochemicals, fertilisers and "clean energies". PER 5x. No impact.

- Rest of companies (20%): **Samsung, Danieli, Wilhelmsen, Elecnor, Técnicas Reunidas,** etc. Some of them may have some moderate impact, but most have broad net cash and strong market positions in their sectors. Neutral or moderately negative impact.

These companies represent the fundamental part of the portfolio and makes us feel very calm regarding the recovery of prices and reaching their value. Our portfolio was trading at PER 6/7x when the year began and is now trading at PER 4/5x, levels very close to the 2009 lows. Remember that the market, despite declines, is still trading at multiples well above those in our portfolio, so there is plenty of room for that recovery. And the recovery will come, as it always does.

We also highlight that both the product of the sale of the securities that are performing well (transport of oil and derivatives) and the possible entry of investors, we are investing in quality companies, a good financial position and the possibility of short-term recovery after a sharp decline. Given the general falls, it is not necessary to sacrifice quality by investing in shares that may raise doubts in a difficult environment.

Last two comments before finishing

Since 1980, the year China began its great economic development, there has been no year of global recession (measured in terms of PPP, purchasing power parity). We repeat: no year. The last year of growth of less than 2% was 2009. We would like to emphasise with this that it is not easy to enter a global recession. We do not know if 2020 will be the first time, but the apparent normalisation that is taking place in China makes us reasonably optimistic.

Lastly, we must insist that the value of our investments or businesses does not depend on our neighbour or partner selling a stake at any price. This can be done out of necessity, ignorance, panic, automatic purchase/sales made by machines, or because half of the investment in the stock market is made in passive funds, without thinking. This does not affect our valuations, which only and always depend on the ability to generate profits from the business or the company. Today we have briefly reviewed our capacity in light of recent events, which gives us a lot of peace of mind.

This is the situation and our best interpretation of it today. You have the full support of the **Investor Relationship Team** to answer any questions you may have.

From now on, we are committed to continue communicating as events occur that allow us to better assess their effects.

Best regards,

Francisco García Paramés