cobas

asset management

Letter to investors from Francisco García Paramés

Madrid, March 7th 2017

Dear investor,

On 3 February 2017 the Spanish CNMV (securities market regulator) entered **Cobas Asset Management SGIIC SA** on the Administrative Register of UCITS Management Companies (Registro de Sociedades Gestoras de Instituciones de Inversión Colectiva), thus enabling **Cobas Asset Management SGIIC SA** to engage in the management and commercialisation of collective investment schemes (funds). Shortly after that, we received authorisation on 17 February to transfer the **Cobas Selección FI** investment fund to our own fund management company and on Friday, 3 March we received clearance to manage our first four funds, commercialisation of which will commence on Wednesday, 8 March.

Cobas Asset Management SGIIC SA is a further piece of a larger project that started life back in 1989 and pursues the underlying tenets and principles of value investing. Our funds and schemes are open to all investors wishing to take part.

It is an ambitious and far-reaching venture with a long-term outlook that is fundamentally different to other funds currently operating in the market. **Cobas Asset Management SGIIC SA** is here precisely because other options have come up short, either by picking an excessively high volume of assets or by failing to adhere to the principles of value investing, which always seeks out undervalued securities rather than making predictions as to how the market will perform

Philosophy

The guiding investment philosophy we intend to follow is well-established and remains unchanged: buying undervalued assets with the ultimate aim of preserving (and if possible increasing) the purchasing power of our clients' savings with a long-term outlook. We have always remained faithful to this approach and we always will.

We make no attempt to predict the short-term performance of the markets, which are as unpredictable as the people that populate them. Instead, we aim to predict the long-term performance of those securities that interest us, meaning well-priced companies that offer both quality and stability, allowing us to understand them fully. It is worth noting that in 25 years of investment management, only sometimes have we got it right with wider predictions (the dot-com and wider market bubble of 1998-2000, the Spanish real estate market and lending bubble, economic growth in China). How the markets perform is therefore of little concern to us and in fact we welcome volatility (which helps generate value) and market dips and collapses since they push down the prices of the assets that interest us, even though we may suffer in the short term.

We will almost invariably invest at close to the legal limit of 99%. As I explained in my book Invirtiendo a largo plazo (Investing in the Long Term), we are not prepared to assume the dangers of investing in fixed-income securities and the money markets due to the risk of our chosen currencies depreciating in value, especially while the authorities are experimenting with monetary policy, as is currently happening. Except for the Spanish portfolio in 1998, the fact is that there have always been -and there will likely be in future- ample securities with which to reach our total investment for the portfolios, and this still holds true even though we are generally unwilling to pay out more than twelve years of earnings (PER 12x).

If a new opportunity presents itself while we are already at full investment capacity, we will sell off our least attractive existing company in the portfolio; perhaps the one closest to its price target. When asked the question, "When do you sell a security?", we always offer the same response: when a better opportunity presents itself. That is our permanent objective: improving our portfolio each and every day.

We will invest mainly in Europe -our local market and therefore one we know intimately- while also acquiring smaller positions in the United States and in Asia. Investments in other markets will be undertaken only in exceptional cases.

Team

We have deployed everything we need to embark on our venture and to pursue our chosen investment philosophy.

We have a magnificent team of analysts and managers comprising a select team of professionals. Some of them are fully familiar with our investment process, since we have worked together for many years: **Iván Chvedine, Carmen Pérez Baguena, Mingkun Chan, Juan Huerta de Soto and Juan Cantus.** All of them have had difficult decisions to make over the past two years (as has **Mayte Juárez,** our head of trading, and numerous other colleagues) and I truly believe they have made the right choice, not only for themselves -in that it shows enormous maturity and personal quality to make the right decision at critical points in life-but also for **Cobas Asset Management SGIIC SA** and our joint project.

To this core team we have added a further four fund managers and analysts with an average of 20 years' experience in their chosen field, namely **John Barden, Vicente Martín, Andrés Allende and Peter Smith.** I have known nearly all of them for some time and so it was not a hard decision for all of us to make.

Together we comprise a culturally-diverse team with a wealth of experience, featuring no less than five different nationalities: Peruvian, Taiwanese, North American, English and Spanish. Our investment ideas are of the highest quality and promise considerable upside potential, as we will discuss below.

At the heart of our management company and team of analysts and managers we have set up an experienced **Board of Directors** and placed strong and capable teams in charge of **investor relations, finance and administration, IT systems and of course our trading desk.** Thanks to all of them and the efficiency of our market regulator, the Spanish CNMV, we have successfully secured all authorisations in no time at all.

Because our managers, analysts and other team members all know what they are doing, we have been able to spend most of our time doing what we do best: analysing undervalued assets.

Products

We will manage five funds at the outset::
• **Cobas Selección FI.** 90% global equity and 10% Iberian equity
• **Cobas Internacional FI.** Global equity.
• **Cobas Iberia FI.** Iberian equity.
• **Cobas Grandes Compañías FI.** Global equity in companies whose stock market capitalisation exceeds €4 billion.
• **Cobas Renta FI.** 90% short-term fixed income / 10% equity.

These funds will follow the three basic strategies we intend to pursue:
1. Iberian equity.
2. Global equity.
3. Equity focused on large companies.
The first fund for which we provide advice, namely **Cobas Selección FI,** is currently being commercialised by **Inversis Gestión SA SGIIC.** Unfortunately, this situation caused certain delays in fund subscriptions during the first few weeks, although thanks to the hard work of both Inversis and ourselves, we have managed to bring subscriber waiting times to acceptable levels and that is where we currently stand. The fund will soon be managed and commercialised by **Cobas Asset Management SGIIC SA.** We are immensely grateful for the patience shown by fund investors during this initial period.

All these funds will be open to a wide range of investors, as from April onward the minimum investment will be just one unit (already the case with **Cobas Selección FI).** In March, we will require a minimum investment of €25,000 for the other four funds so as to be able to provide proper service to all interested parties and fine-tune our processes.
We will soon be able to offer pension funds and funds domiciled in Luxembourg.

Portfolio

We have been pleasantly surprised to find a large number of attractively-priced companies that meet our quality standards; surprising in the sense that the markets have been performing reasonably well in recent years.

To provide a brief outline of recent events in 2015 and 2016, the markets performed extremely well in the first half of 2015, with numerous securities reaching all-time highs (look no further than the common stock of **BMW,** which climbed past 120 euros), thus making it more difficult to find interesting opportunities. However, this buoyant climate ended abruptly in the summer of 2015 due to the apparent malaise of the Chinese economy.

This situation caused oil and commodity prices to plummet in the latter half of the year, creating in the process the biggest opportunity in the financial markets since 2000 or perhaps 2009. While I attended numerous conferences and events related to the world of commodities during the autumn of 2015, my clearest recollection is of 7 December 2015, when I attended Investor Day at **Anglo American,** one of the biggest companies operating within the mining sector. It caught my attention because their shares were priced at 270 pence, having fallen 90%, and its main asset is **De Beers,** the world's largest diamond company. The atmosphere was so negative in the City of London that it was hard not to feel sorry for its CEO. It struck me as an extraordinary opportunity and the company is currently priced at around 1,400 pence, five times its initial value.

On balance, it has been an interesting couple of years and the result is a tightly-priced equity market, though surprisingly the securities that make up our portfolio are quite remarkable.

Our starting portfolio comprises 62 securities. At the core we have securities already known to us, since 23 companies have previously featured in portfolios managed by our team. These 23 enterprises include the nine that make up the Iberian portion of the portfolio, all of which are old friends.

A further ten securities are related to the raw materials and commodities sector. While we have not invested significantly in the sector since 1998, monetary manipulation from central bankers and price adjustments at most of these companies as a result of the excess investment seen during the 2008-2014 period have meant that it is now necessary and indeed desirable to maintain a certain percentage of our portfolio in these companies (currently close to 20%). It is also worth noting that the companies in which we are currently investing are trading at a price of 10x earnings; a very attractive price when we consider that the prices of their respective commodities are currently so low.

Portfolio

The remaining 29 securities are "new" companies we have studied meticulously so as to get to know them as closely as possible. While we were already keeping a close eye on some of them, others have been interesting surprises for the future.
The hallmarks of our portfolio are as follows:

- ROCE: 30%. Climbing to 34% if we exclude companies engaged in the commodities sector. ROCE, meaning return on capital employed, is a measure of business quality and remains very high at all our companies.

- Price, measured as earnings yield (earnings/stock market capitalisation+debt): 13.4%, equivalent to a PER of 8.4x, a very attractive figure, particularly if we consider that some securities are currently passing through a low side of the cycle, and one that affords us a generous safety margin. Let us not forget that market PER is presently at 17x, meaning our portfolio offers a discount of over 50% on the market level.

- Upside potential: 70%. While this may seem high, this is actually not the case once we factor in the quality of our companies and the low multiples we are paying for them. The fact is that historically our valuations have been reasonably correct. For instance, over the last four years, the main investments made by the portfolio we managed in 2012 have shown remarkable returns that are consistent with our initial valuation of the stock.:

Wolters Kluwer	122%
BMW	49%
Thales	251%
Schindler	37%
Exor	116%
Media	115%
Stoxx 600	29%

(Revaluation between 01/01/2013 and 31/12/2016))

Despite its upside potential, it remains a conservative portfolio since companies with net cash account for 38% of the portfolio; some of these companies (22% of the portfolio) have net cash at around 50% of their stock market cap, while net cash at four companies (representing 6% of the portfolio) exceeds their stock market value (plus good businesses). Most of the portfolio -around 80%- comprises family-owned companies or companies with just one controlling shareholder.

Given the prevailing market conditions, it is once again a surprise to find companies offering such attractive features, which are similar to those we saw in our best investments over the years and which ultimately promise very healthy returns on our savings.

Limit On The Volume Of Assets Under Management

Regrettably our investment style cannot be applied to unlimited amounts of money and we do not intend to do so. Here, we have to juggle two opposing forces. Although we want to allow as many people as possible to take part in a management approach we consider attractive, it is also true that finding value becomes increasingly difficult the more assets we have under management. Striking a balance between both is no easy task, yet a decision needs to be made and that is what we have done.

The two basic strategies, namely Iberian and global, will therefore be subject to the following limits:

•**Ibérica:** between 750 million and 1 billion euros between all funds that apply the strategy.

• **Global:** between 4 and 5 billion euros between all funds that apply the strategy.
The logic behind these limits is undisputable: when we exceed 5/6 billion euros in assets under management we need to invest in large companies and we do not feel a management approach centred on large companies can realistically charge similar fees to those levied by value added funds, which can invest in all types of shares. For this reason, we draw a distinction between basic funds, with high fees, and funds focused on large companies, with a management fee of 1% a year. The latter will enable Cobas Asset Management SGIIC SA to report healthy growth above the amounts set as limits for our "classic" funds.

The first example of these limits coming into play will be seen in the case of **Cobas Selección FI,** which had assets of 450 million euros at 6 March and which will "restrict" access upon reaching 2 billion euros.

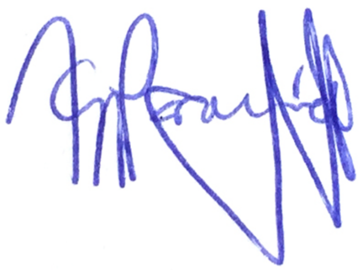
In any event, the limits will be flexible and may be adjusted accordingly to reflect prevailing market conditions.

• The third strategy, focused on **large companies,** will have a larger investment capacity and limits will be placed only upon reaching significantly higher amounts.

Communication

This personal message marks the start of a long process of dialogue and communication with investors who believe in our way of doing things. This process will include an opinion and information blog and a whole raft of activities to help savers and investors expand their knowledge, all with the ultimate aim of protecting and increasing the purchasing power of their savings.

Thank you all for choosing and trusting in our management approach. At **Cobas Asset Management SGIIC SA** we continue along the same path we have been following for many years; a path we can now follow together. My family and I already invest all our available savings in the funds managed by **Cobas Asset Management SGIIC SA** and we will always continue to do so.



Francisco García Paramés