Dear fellow investors and friends,

During the second quarter of 2020 the fund gained 14.88% gross of fees[1]. We have been told by our fund's administrator and our compliance that there is a new rule in which we should not be comparing ourselves to specific indices unless they are clearly stated as our benchmark in our Key Investor Information Document (KIID). As we have no stated benchmark, we will leave it up to you to decide our relative performance. We would note that to us the above number appears slightly better than most European benchmarks, slightly below global indices which include the USA and in line with small and mid-cap value indices. However, while the Palm Harbour Global Value Fund posted a good quarter, this performance was not enough to make up for the first quarter's results and it ended the first half down 25.87%. Our fund's composition is unlike any index and we are unlikely to perform in a similar manner.

Global markets rallied during the second quarter and generally posted solid gains as economic stimulus plans, easing lockdown restrictions and central bank money printing led to investor optimism. While most stocks benefited to some degree, the majority of the gains in the major indices were concentrated in the technology and healthcare sectors. This was nowhere more extreme than in major US indices where the mega-cap tech companies, well known to us all, made up the bulk of the gains. Those companies with more sensitivity to the economic environment (and without cult followers), or heaven forbid, the virus, largely suffered beyond realistic mid-term fundamentals.

We were disappointed that valuations across our high-quality compounder watchlist remained highly elevated even at the depths of the sell-off in late March. Many of the high quality companies that we follow, and looked forward to becoming shareholders in, merely went to "less expensive" or borderline "fair value" and did not even remotely come close to the discounts to intrinsic value that we seek or the valuations found during the global financial crisis that we have longingly dreamt of. During the

[1] Our NAV is calculated weekly by FundPartner Solutions, a subsidiary of Pictet & Cie and does not align with monthly or quarterly reporting. The gross return stated is net of taxes and fees but before fund expenses, which are currently running at approximately 10 bps per quarter at current AUM. We project this to decline significantly as AUM grows. Please see our comment on mgmt. fees.

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sell-off, we mostly added to existing positions, although we did add to a couple of new positions, two of which we will discuss later in this letter.

While there were a few weeks of value outperformance, generally momentum and COVID-forever stocks regained their popularity and the gap to “growth” widened to extremes not seen since the tech bubble in the late 90s. This was personified in the oft quoted popularity of Robinhood and the day traders who bid up the most popular *stock du jour*, including profitless “tech-growth” companies, bankrupt companies, and frauds. These classic signs of a bubble contrast starkly with the economic ruin occurring in large parts of the economy.

Not to beat a dead horse, but we remain highly sceptical that money printing is the solution to all economic problems. Before the virus and a decade after the global financial crises, we had not managed to normalize central bank policy. The task of unwinding the current policy on steroids as well as reduce our record debt and deficits seems impossible without inflation. We fear the moral hazard created, and the gross misallocation of capital is slowly destroying capitalism. Policies designed to inflate asset values and bail out leveraged private equity investments helps a relatively small minority of wealthy people. The vast majority of people suffer with low savings rates and are forced to buy assets at outrageously inflated prices. At some point the majority who are not benefiting from these ill-conceived policies will make their voices heard. We think owning a portfolio of undervalued businesses is the best way to invest for the long-term in these exceptional times. We are very happy with our portfolio and look forward to the future.

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The largest contributors were broadly the largest positions in the fund including Bayer, Befesa, RHI Magnesita and Wabtec. The exception was the third largest contributor, IGT, mentioned in our last letter, which was up close to 50% on news that they received a covenant waiver on their debt, lottery ticket sales were improving and casinos were opening to strong demand.

Bayer performed well in the second quarter as a deal was announced to settle their outstanding glyphosate litigation at slightly better terms than market expectations. However, after quarter-end the judge in charge of the settlement asked the parties to renegotiate a portion of the deal, which has thrown the deal into doubt. We expect the parties to find a solution, which will hopefully remove this critical overhang. While we expect some impact from the virus in the pharma division (doctor visits are down) we believe the agriculture and the consumer divisions remain mostly ambivalent to COVID. At less than 8x earnings, the shares trade at a significant discount to peers.

Aryzta, which we discussed in our Q4 2019 and Q1 2020 letters, saw the intensification of an activist campaign as two major holders combined their holdings to demand an Extraordinary General Meeting in September at which significant changes are proposed to the board. We applaud their aims, which include bringing back much-needed bakery experience to the company's leadership. We added a small position in their junior debt – the hybrids – in addition to our equity position.

Esprinet, the Italian IT distributor introduced in the Q4 2019 letter, showed its resilience, reporting that its sales had grown by 4% in the first quarter and acquiring a competitor in Spain. As one of the few Italian companies to have done well in the period, its share price benefited, but we believe it still represents great value at current levels so continue to hold.

Our largest detractor was also one of our larger positions, OCI NV. The shares did not participate in the broader rally. We are relatively unconcerned as the mid-term fundamentals are still positive. While urea and ammonia prices remained below their prior-year levels in the first quarter, pressured by Chinese exports reliant on economically and environmentally questionable coal production, planting conditions have been good this year, so demand for fertilizers has been solid (and unaffected by coronavirus) both in North America and Europe as well India and Brazil.

However, methanol, which made up 14% of EBITDA in the first quarter, dragged the company's results down. Like fertilizers, it is typically made using natural gas, though its uses are industrial rather than agricultural. Demand from industries such as construction and transportation was impacted by Covid-19, whilst demand from the petrochemicals industry (where it is a substitute for oil-derived naphtha) was hurt by the plunge in crude prices. Diesel exhaust fluid (DEF), another non-fertilizer product made by OCI, also saw temporary demand weakness as driving miles were hit by the virus. We expect the end markets to improve gradually and as prices normalize we think the methanol division will eventually be sold.

CIR, introduced in the 4Q 2019 letter, is an Italian mini-conglomerate that slimmed down from three divisions to two during the quarter with its sale of newspaper group GEDI. This leaves it with the car parts maker Sogefi, and, accounting for the great majority of its earnings, the healthcare group KOS - as well as a sizable cash balance. With facilities in Italy and Germany, KOS was hit hard by the lockdown in Italy which forced it to suspend clinic visits during the quarter. Its nursing homes sadly suffered deaths from Covid-19, though death rates do not look out of line with a normal year. We expect results to improve over the rest of the year as clinics get back to work and

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occupancy in nursing homes gradually returns to normal levels. The recently acquired German operations (just under one third of revenues) largely escaped the virus. We think the company will continue to transform its portfolio and expect value enhancing strategic moves in the future.

We were pleased to see significant recent insider buying at a number of our companies – some examples include:

- OCI Chairman Nassef Sawiris bought €65 million worth of shares.
- RHI Magnesita Chairman Herbert Cordt bought £8.3 million worth of shares, while CEO Stefan Borgas increased his stake by over £100 thousand.
- The CEO of a holding listed in Hong Kong invested HK$152 million ($20 million) in his company's shares.
- The CEO of a German company bought close to €1 million worth of shares as another insider bought €560 thousand.

At quarter-end, our portfolio had slightly over 140% upside to NAV, a weighted average P/E of 7.8x, FCF/EV yield of 18%, return on tangible capital of 34%, net debt/EBITDA of 1.5x and traded at 7.7x EV/EBIT[2].

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MTU Aero Engines AG (MTX GY)

When the crisis struck we looked around for high quality companies that had been overly penalized by the market. Whilst we found few bargains in the high-quality camp, there were some that had been affected by the virus. We had previously invested in MTU Aero Engines when it was out of favour back in 2013 and saw extraordinary gains. We think we will be rewarded this time as well.

MTU makes aircraft engine parts, and though it looks like a mere supplier it is functionally an Original Equipment Manufacturer (OEM) developing subsystems and earning an equity stake in the engine programmes it participates in. This is generally a good business to be in, with a razor blade model that gives away engines at or below cost and generates the bulk of its profits from highly marked-up aftermarket engine servicing and spares. Aircraft engines are an oligopoly (or a duopoly in the case of

[2] The EV/EBIT jumped in Q2 compared to Q1 primarily through the introduction of IFRS 16 lease liabilities into our net debt and enterprise value calculation, although some companies also experienced higher debt and/or lower earnings.

narrow-bodies), so there is little scope for new entrants to compete with the OEMs in the market for spares, and if engines are flying, they must be maintained. The key driver of recovery will be the extent to which airlines fly their planes, and we have begun to see that metric outpace the return of passengers to the skies (airlines are flying emptier planes than before). There are bright spots in freighters, which are seeing strong demand, and in China, where normality is beginning to return. The defence business also remains robust.

There is no hiding the fact that things will be ugly for a while but that's what gave us our entry price. We expect the airline industry might take three to four years to recover to 2019 levels (though it could be quicker, we certainly would like a holiday!), but it will recover because people want to travel and there are still billions of people who have barely set foot on a plane.

MTU has long been managed conservatively and has a strong balance sheet, with June net debt of €790 million on a 2020 trough EBITDA forecast of €440 million placing it on 1.8x leverage. On our assessment of normalized (and growing) earnings, we purchased the shares with a double-digit free cash flow yield.

ASTM SpA (AT IM)

One data point that struck us during the crisis was how quickly Chinese road traffic returned to normal versus public transport and air travel. This of course makes a lot of sense as goods still need to be delivered, if perhaps more by Amazon than to retail shops, and people feel safer traveling in their own car than by other methods of transportation.

We spotted the chance to invest in infrastructure using this theme at a bargain price in the form of Italian toll road operator ASTM SpA. We had followed the merger of the holding company ASTM SpA with its subsidiary SIAS SpA, which completed at the end of 2019 and which also saw the introduction of Ardian, a well-known professional infrastructure fund into the Gavio family's holding company, which controls ASTM SpA. The removal of the holding company discount and the stated intention to consolidate their 49% stake in Brazilian-listed Ecorodovias helped boost the shares prior to COVID. We believe Ardian and the Gavio family have additional plans to help realize the value of the company.

The company's ten road concessions are in prosperous northern Italy, where lockdown had a dramatic short-term impact on road usage. Ecorodovias has a further 11 concessions in Brazil, where the growth pipeline is also very large. Since the crisis began not only have road statistics improved each month but also ASTM has executed three transactions and announced a deal with the Almeida family to gain control and consolidate Ecorodovias.

Risks include the Italian regulatory regime, which seems intent on punishing Atlantia SpA for the Genoa bridge collapse.

With the company trading at a double digit free cash flow yield, having a large pipeline of growth opportunities, having a strong management and being controlled by long-term value-seeking shareholders, we feel the temporary dip in traffic provides an excellent entry point.

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As stated in our previous letter, we are currently not charging a management fee until the fund reaches a larger size. The founder's class management fee will then be only 1% of assets under management.

Our focus is and remains the portfolio, but we do need to grow our assets to a sustainable level. Our fund can be invested through both European international central securities depositories: Euroclear and its FundSettle clearing platform and Clearstream through the Vestima fund clearing platform. Our fund is registered for distribution in the UK, Spain and Luxembourg including for retail distribution. Currently the following financial institutions in Spain are distributors: BBVA, Renta 4, Lombard Odier, Banco Alcala as well as many other institutions working through the main platforms in which the fund is available upon request: Allfunds Bank and Inversis. In the UK we are offered on the AJ Bell low-cost platform Youinvest.co.uk and can be part of an ISA or pension. If you have any issues finding our fund, please contact us at IR@palmharbourcapital.com

During the quarter and shortly after one year of marriage, Tom and his wife welcomed a baby boy into the world. He has already participated in several Palm Harbour Capital conference calls. Congratulations!

We appreciate your support over the past year.

Yours faithfully,

Palm Harbour Capital

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