

**Interim letter to the co-investors of the BrightGate Focus Fund
1st half of 2024**

July 3rd, 2024, Madrid

“People who have information about an individual case rarely feel the need to know the statistics of the class to which the case belongs.”

Daniel Kahneman: Pensar Rápido, Pensar Despacio.

Dear co-investors,

The Fund closed on 30th June with a NAV (institutional class) of 1,699, representing a return of 9.7% over the six-month period, compared with 15.3% for the S&P500, 11.7% for the MSCI World and 2.6% for the BofA US High Yield Index, in all cases including reinvestment of dividends or coupons but excluding the cost of currency hedging. Although the Fund does not follow any benchmark, I consider the three indices above to be a representative group of the asset universe (equities and high yield bonds) in which the strategy invests.

As I have said in previous years, half-year results should be interpreted with caution. While I believe that over the long term the performance of the Fund will be in line with the objectives set at inception, short-term movements in NAV, both up and down, can be largely random and not representative of the value creation (or destruction) that has taken place in each of our companies.

The Fund's performance over the six-month period was similar to that of the indices, although, as in the previous year, *the gains did not come from the bubble in technology companies (more specifically, those considered by “investors” to be “bets” on the rise of artificial intelligence)*, nor from the "meme" stocks, which have seen their share prices rise for purely speculative reasons, but whose future remains uncertain from a fundamental point of view, to say the least.

In historical episodes of stock market bubbles as large as the current one (events so rare that they are "three sigma", to borrow [Jeremy Grantham's](#) terminology), *the focus must be on capital preservation* and one must have a realistic assessment of what can and cannot be achieved in terms of long-term returns.

To anchor minimally such expectations in these times of euphoria, it may be instructive to consider the following analysis from Barron's:

“The failure of the general market to decline during the past year despite its obvious vulnerability, as well as the emergence of new investment characteristics, has caused investors to believe that the U.S. has entered a new investment era to which the old guidelines no longer apply. Many have now come to believe that market risk is no longer a realistic consideration, while the risk of being underinvested or in cash and missing opportunities exceeds any other.”

The above paragraph would be unremarkable except that it was written in February 1969, a few years before one of the worst bear markets in US history.¹ Then, as now, the past performance of stock indices was the "ultimate proof" of their infallibility to deliver the same returns in the future. As with many other episodes in history, things turned out quite differently in the end, demonstrating once again that much has already been invented in financial markets and that there are few new truths under the sun.

I continue to believe that *the outlook for passive equity investors from now until the end of this decade will be similar to the experience of fixed income investors over the past decade, characterised by poor returns (close to zero in real terms), excessive volatility and the possibility that truly active managers will have one of the best periods versus indices of the past three decades, as has recently been the case for their fixed income peers.*

Before turning to the current composition of the portfolio and the main investments and divestments made in recent months, I would like to use this half-yearly letter to explain in more detail one of the aspects of our investment process that I consider to be most important, and which comes from the behavioural economics literature: the use of base rates.

Investing, Fast and Slow

The Israeli psychologist Daniel Kahneman passed away on 27 March at the age of 90. Winner of the 2002 Nobel Prize in Economics along with Vernon Smith² and famous for his best-selling book "Thinking, Fast and Slow" published in 2011, Kahneman (and his collaborators) has been one of the thinkers who has most influenced me intellectually, and I thought it appropriate to devote a small section of this letter to explaining, with concrete examples, how some of the concepts of behavioural finance have influenced the management process of our two funds.

Kahneman's most famous contribution to behavioural finance is the "prospect theory", a framework he first developed with his friend Amos Tversky in a paper published in 1979.³ With this contribution, the two Israeli psychologists proposed an entirely new theoretical framework for how people make their daily decisions, starting from assumptions and arriving at conclusions very different from those of the conventional models used by economists.

While the latter focus on the "utility" of a given good or action in absolute terms (e.g., the utility of winning a 100 euro prize is greater than that of winning a 20 euro prize), Kahneman and Tversky advanced the idea that the way we value things is not so much in absolute terms as in relative terms, *always starting from a reference point from which we value the change we experience as a "gain" or a "loss"*. Moreover, the shape of this statistical function (which they called the "value function") is asymmetric, because people are "loss averse", feeling a unit of loss much more strongly than a unit of gain.

¹ John Hussman, 2023, "When the Bough Breaks" (link [here](#)).

² Vernon Smith was the driving force behind experimental economics. In my letter in the first half of last year ("Bubbles in the laboratory"), I explained some of the main implications of this branch of economics for financial markets.

³ Kahneman, D. and Tversky, A., 1979. Prospect Theory: An Analysis of Decision Under Risk. *Econometrica*, 47(2), pp.263-292.

In addition to the value function, the second pillar of prospect theory is to explain how people form an idea of the probability distribution of an event. In contrast to conventional economics, where agents know about the range of probabilities that open up after taking a particular action, prospect theory argues that we operate with a "probability weighting function", where *we simply substitute objective probabilities for subjective ones*. Specifically, the theory argues that we underestimate high probabilities (for example, a 99% probability "feels" closer to 95% than to 100%) and overestimate low probabilities (a 1% probability feels closer to 5% than to 0%). This shape of the probability weighting function elegantly explains why, in the real world, the same person might want to buy an expensive insurance policy against highly unlikely events and at the same time buy a lottery ticket.

Taken together, prospect theory explains many phenomena we see in the financial world that an economist would consider highly irrational, such as the tendency of managers to sell their winning investments and hold on to their losing ones (with losers we are in the "realm of losses" and we, being loss averse, do not want to realise them; this is known as the "disposition effect"), overweighting the probability of highly unlikely events (which makes "lottery" stocks, i.e. those with a highly asymmetric distribution of returns, more expensive), and people with excessively short investment horizons ("myopic loss aversion").

However, I did not want to devote this letter to explaining the applications of prospect theory to the world of asset management (something I hope to do in future letters), but to another concept popularised by Kahneman and Tversky that we use extensively in our day-to-day fund management: the use of base rates.⁴

Base rates are a fundamental concept in statistics, psychology and many other fields. A base rate refers to the frequency with which an event occurs in a general population, before any specific information about a particular case is considered. Generally speaking, a forecast always requires a combination of the following three components is always needed: the inside view, the outside view, and the relative weights we give to each of the two.

The inside view consists of taking the elements that are specific to the problem at hand and using them exclusively to make our forecast. For example, if we want to estimate how long it will take us to write a new book, the internal view will only take into account the factors specific to our case, such as our knowledge of the topic, the time we will devote to it, how motivated we are at the beginning, or the pressure our publisher puts on us.

The outside view takes a diametrically opposite position when making forecasts. It requires us to abstract from the specifics of our case and estimate only the average probabilities of similar events ("reference class") that have occurred in the past. Continuing with the book example above, the outside view would require us to obtain specific information about how long it has taken people on average in the past to write a similar book.

All the studies that have looked at the accuracy of our forecasts come to similar conclusions: *forecasts made using only the inside view invariably produce overly optimistic results*. The recommendation of Kahneman, Tversky and the rest of the behavioural finance literature is to start with an outside view of the problem (the base rates) and then adjust that forecast with the relevant elements that the inside view can provide.

⁴ For an excellent introduction to prospect theory, see Barberis, N.C., 2013. Thirty Years of Prospect Theory in Economics: A Review and Assessment. *Journal of Economic Perspectives*, 27(1), pp.173-196.

Although base rates can be difficult to obtain for certain problems (this is one of the main pitfalls of using base rates in other areas), the amount of data available in the financial world allows us to make use of them. To illustrate how we handle them in our investment process, I would like to give two different examples: firstly, to understand the persistence of a company's profitability and, secondly, to have a more accurate estimate of the default rates of our bond portfolio.

One of the best-known phenomena in economic literature is the persistence of a firm's profitability over time. Although the principles of competition tell us that high profits attract competition that will eventually eliminate those profits, such a process of reversion to the mean usually takes a long time to reach its final logical conclusion.

In their exceptional study of the base rates of key financial measures of US listed companies over the period 1983 to 2015, Mauboussin and colleagues showed that while the past performance of some financial measures had no predictive power of their likely future performance (for example, past sales growth does not help predict future sales growth), other variables did have high predictive power, including return on capital employed.⁵

For example, the table below shows that the current return on capital of a company operating in the non-cyclical consumer sector explains, on average, 78% of the return on capital of the same company four years later. In other words, for most sectors (with the exception of energy, materials and financials, whose companies are more dependent on macroeconomic factors such as commodity prices or interest rates than on sustainable competitive advantages), *profitable companies will, on average, continue to be profitable for years to come, while unprofitable companies will continue to struggle to clear their cost of capital.*

Exhibit 7: Rate of Regression and toward What Mean CFROIs Revert for Ten Sectors, 1983-2015

Sector	How <i>Much</i> Regression?	Toward <i>What</i> Mean?			
	Four-Year Correlation Coefficient	Median (%)	Average (%)	Standard Deviation (%)	Coefficient of Variation
Consumer Staples	0.78	8.1	9.3	0.6	0.07
Consumer Discretionary	0.67	8.0	9.1	0.6	0.07
Health Care	0.64	8.3	7.6	1.1	0.15
Industrials	0.62	6.7	7.6	1.0	0.12
Utilities	0.57	3.5	4.1	0.8	0.20
Telecommunication Services	0.55	5.7	5.3	1.4	0.27
Information Technology	0.50	8.5	9.0	1.6	0.18
Financials	0.43	7.5	8.3	1.5	0.18
Materials	0.41	4.6	4.7	0.9	0.19
Energy	0.35	5.0	4.9	1.7	0.34

Source: Mauboussin et al., 2016. *The Base Rate Book: Integrating the Past to Better Anticipate the Future*. Credit Suisse Global Financial Strategies.

A competent analyst who wants to follow the recommendations of behavioural finance in order to improve his forecasts of a company's profitability will start with the historical profitability and adjust his estimate from there according to the importance of the information brought in by his inside view.

The above analysis should not be seen as a purely academic exercise. In fact, it is a process that has been used to a greater or lesser extent by the best investors in history. For example,

⁵ Mauboussin et al., 2016. *The Base Rate Book: Integrating the Past to Better Anticipate the Future*. Credit Suisse Global Financial Strategies.

here is what Buffett had to say about the importance of change (or the lack of it) during the question-and-answer session at Berkshire's 1999 AGM:

“But we do not get enthused about — with a few exceptions — we do not get enthused about change as a way to make a lot of money. We try to look at — we’re looking for the absence of change to protect ways that are already making a lot of money and allow them to make even more in the future. So we look at change as a threat. And whenever we look at a business and we see lots of change coming, 9 times out of 10, we’re going to pass on that.”

Apart from the possible difficulty of finding a reference class, the reason why people do not use base rates more often is that it is a seemingly very simple procedure – too simple. In his recent book on project planning,⁶ Bent Flyvbjerg, one of the world's leading authorities on the planning of large projects, uses a very specific case (a humble kitchen renovation) to explain very clearly why people do not use the outside view more often in planning:

“I know from experience that people sometimes struggle with this, not because it’s complicated but because it’s simple. It’s too simple. Their project is special, after all, or so they think, and this process doesn’t emphasize that, so they complicate the process. They think that if they’re doing a kitchen renovation, they shouldn’t say that “one of those” is “the class of kitchen renovations.” That’s too easy. Instead, they try to create a tightly drawn, complicated definition of the class that seems to neatly fit their particular project. Instead of seeing the class as “kitchen renovations,” they call it “kitchen renovations with granite countertops and German appliances in high-rise condominium units located in my neighborhood.” That’s a mistake. It ignores a lot of useful information. And it makes it much harder to gather the necessary data, a challenge I’ll discuss below.”

Moving on to our second example, we also make extensive use of base rates to understand some of the key metrics of our fixed income investments.

Fortunately, fixed income is probably one of the areas where it is easiest to incorporate base rates into the analysis. This is due to the existence of rating agencies, which have an extensive database covering the performance of a large number of fixed income issues over several decades.

When the information is of such high quality, not only is the application of base rates greatly simplified, but *both the accuracy of the predictions and the importance of the outside view are greatly increased.*

The table below, courtesy of Standard & Poors, shows some of the key one-year default rate statistics for fixed income issues from 1981 to 2021, sorted by rating. You can see, for example, that default rates increase in a roughly linear fashion up to about BBB (0.15%) and then begin to grow exponentially (on average, B's are five times more likely to default in a year than BB's).

⁶ Flyvbjerg, B. and Gardner, D., 2023. *How Big Things Get Done: The Surprising Factors That Determine the Fate of Every Project, from Home Renovations to Space Exploration and Everything In Between.* Crown Currency.

Descriptive Statistics On One-Year Global Default Rates

	AAA	AA	A	BBB	BB	B	CCC/C
Minimum	0.00	0.00	0.00	0.00	0.00	0.25	0.00
Maximum	0.00	0.38	0.39	1.02	4.24	13.84	49.46
Weighted long-term average	0.00	0.02	0.05	0.15	0.60	3.18	26.55
Median	0.00	0.00	0.00	0.06	0.58	3.40	25.00
Standard deviation	0.00	0.06	0.10	0.25	0.99	3.25	11.86
2008 default rates	0.00	0.38	0.39	0.49	0.81	4.11	27.27
Latest four quarters (2021Q1-2021Q4)	0.00	0.00	0.00	0.00	0.00	0.52	10.99
Difference between last four quarters and weighted average	0.00	(0.02)	(0.05)	(0.15)	(0.60)	(2.67)	(15.56)
Number of standard deviations		(0.28)	(0.51)	(0.59)	(0.61)	(0.82)	(1.31)

Source: Standard & Poors, 2022. 2021 Annual Global Corporate Default And Rating Transition Study.

If credit ratings were incorrect or randomly assigned, we would not see the increase in default rates shown in the series. This table is just a tiny sample of the vast number of base rates available to a fixed income analyst, many of which we use in our analysis of the issues we hold in our portfolios.

Over time, we have found that, with the exception of a few issuers (especially those in which we have been invested for many years), *the analysis process becomes more efficient and accurate if, instead of starting with a blank sheet of paper, we start with the credit ratings (outside view) and adjust the forecast with our analysis (inside view)*. In some cases, this adjustment may be large (as in the case of emerging market issuers whose credit rating is constrained by the sovereign), but in most cases the adjustment will be minimal, at most one or two notches.

Finally, one might think that in the latter cases (where our view is close to that of the credit rating agencies) the value that a manager can add is practically nil, as the information should already be priced in by the market. I could not disagree more with this statement, as our experience shows the opposite. For example, at the end of last year, the perpetual bonds of General Motors, an investment grade issuer, were yielding as much as 12% (in dollar terms), while similar bonds were yielding 5%. The unique feature of the issue was that it was a floating coupon bond at a time when everyone wanted exposure to longer maturities. As I write this, the yield on such a General Motors bond has narrowed to around 7% (with a corresponding rise in the price of the bond), and indeed there are still investment grade floating bonds with yields (in dollar terms) above 7%, more akin to "B" rated bonds, but obviously with default rates one tenth lower than the latter.

Structure of the portfolio

At the end of June, the portfolio structure was as follows. We have invested 59% in equities, 6.7% in special situations (only through our position in Liquidia), 16% in fixed income and 3.6% in preferred shares. In addition, the fixed income portfolio has a yield to maturity of 7.9% (after taking into account the cost of hedging into euro) and a duration of 1.5.

It is worth noting that, as I explained in the introduction, given my near-zero expectations for real returns on the major developed equity indices over the next few years, *I believe the*

yield on our bond portfolio is both highly attractive and has a profile that will provide downside protection when valuations inevitably correct (although I don't know when). I do not rule out adding to our bond positions in the coming months at similar yields to those we already hold. At the end of June, our fixed income positions were American Coastal, Discover Financial, Genworth Financial, Preferred Bank and Textron Corporation.

In terms of sector composition, the main sectors in which we are invested are, in order of importance: consumer discretionary (35%), financials (27%), consumer non-cyclical (6.7%), industrials (6.8%) and technology (6.8%). It should be noted that the companies we hold within each of these broad sectors are very diverse and, with the exception of our exposure to the car dealer sector (where we have invested 15% of the Fund in this theme), the rest of the portfolio is sufficiently diversified. Finally, more than half of our weighting in the financial sector is accounted for by our bonds, with the remainder spread across our positions in Northeast Bank, OSB Group and SLM Corp. From this perspective, the coupons (and dividends) paid by our financials portfolio should allow us to continue to increase the net asset value of the Fund, regardless of what happens to the valuations of these companies in the short term.

Main additions to the portfolio

There were only three new holdings in the Fund during the first half of the year: Atkore (ATKR:US), Group 1 Automotive (GPI:US) and PHINIA (PHIN:US). We also bought the bonds of Textron and Preferred Bank, both of which yielded more than 7% in euros.

As Group 1's thesis is similar to that of Asbury and Lithia, and has been explained in previous letters, I will now detail Atkore's investment thesis. While I will not go into detail about our rationale for investing in PHINIA, suffice it to say that, like Atkore, PHINIA is a US company operating in a cyclical business (auto parts) with excellent returns on capital employed, minimal debt on its balance sheet and a management team incentivised to create long-term shareholder value. In the case of both Atkore and PHINIA, both companies are trading at very reasonable valuations, although the terminal value risk we assume for Atkore is zero, whereas for PHINIA it is not, as its core business (injectors for light and commercial vehicles) will eventually be displaced by the electrification of both the light and commercial vehicle fleets.

Atkore (ATKR:US)

Atkore (ATKR:US), based in Illinois, is a manufacturer and distributor of a broad range of products, including metallic and non-metallic conduit, cable management systems, plumbing and fire protection solutions. Atkore's end markets are predominantly non-residential (although it also has exposure to residential markets), with exposure to sectors as diverse as construction, industrial, energy and transportation.

Although the company is relatively old, having been founded in 1959 as Allied Tube & Conduit, it was not until 2014 that Atkore took on its current form. In that year, private equity bought the remaining 50% of the electrical and mechanical products business from Tyco (the original 50% had been bought in 2010), installed a new management team made

up largely of ex-Danahers and, together with some additional acquisitions they made in the PVC manufacturing business, floated the company in 2016 at a valuation of \$16 per share.

Since then, the company has continued its conservative and successful acquisition policy. Most acquisitions have been made with little debt, and the companies acquired have been relatively small, minimising potential integration risks. To give an idea of the relative size of such acquisitions, one of the largest purchases was the acquisition of Poly Systems, a manufacturer of high-density polyethylene pipes, for \$227M, which is very manageable given Atkore's enterprise value of \$3.6bn that year. Atkore's acquisition policy was aimed both to consolidate its dominant position in the markets in which it operated and to enter new verticals adjacent to its existing products. In particular, Atkore's recent acquisitions have focused on the high-density polyethylene (HDPE) pipe market, a market where Atkore's presence has been minimal until recently and which management has identified as an additional \$7bn sales opportunity. These products are used not only in traditional projects requiring electrical cabling, but also in telecommunications and fibre optic projects.

The natural question at this point is to understand why Atkore's business is a good business, a reality which, as we shall see below, is perfectly reflected in the company's accounts. There are several qualitative reasons, but the most important ones can be summarised in four points.

Firstly, the products it manufactures are bulky and heavy, making them difficult to move over long distances. As a simple rule of thumb, Atkore estimates that it generally makes sense to have factories within 500 miles of its customers. Not only does this make the business dependent on regional dynamics, but the potential for aggressive competition from international companies with excess capacity (i.e., China) is minimal, as freight costs are an important component of the final price, not to mention the difference in delivery times and the possibility of delays on site, both of which are key qualitative considerations for a contractor.

Secondly, most of Atkore's products have been around for a century, so there is very little risk of technological obsolescence. Although there has been some technological innovation in some of these products in recent years, Atkore's vitality index (a ratio that measures the percentage of sales of newly introduced products to total sales) is only 9%.

Thirdly, although the market for tube and cable manufacturing remains relatively fragmented at the aggregate level, the concentration by product line is much higher, with each product line generally held by 2 or 3 manufacturers. For example, the production of metal tubes is divided between 3 producers, which account for more than 80% of the volume. Atkore is one of the few companies that competes in different product lines, and in each of them it usually competes with different companies (e.g. competitors in PVC are different from those in armoured cables). This fact is an important source of competitive advantage over other companies as Atkore can supply all the products needed for a complete project from start to finish. The diversity of Atkore's products means that customers often prefer to deal with one supplier rather than a plethora of suppliers for reasons of convenience. As the management team explained at an analyst conference last year:

“One of the advantages we have, again versus our competitors is we do have this product basket. So, we're able to provide more products on a truck than just one truck full of one product, if that makes sense. Some people like the ability to order multiple things on a truck, get multiple

deliveries, help their working capital, maybe pay a little bit more of a price for that, but that's service we can offer.”

Finally, it would be remiss not to mention the quality of Atkore's management team and corporate culture, which has undoubtedly been one of the reasons for the extraordinary performance of the stock since its IPO. Broadly speaking, the corporate culture was established by the company's previous CEO (John Williamson), who retired in 2018 and had previously spent his career at Danaher. Danaher's legendary process and results culture was transferred to Atkore and codified as the “Atkore Business System”, which is essentially a system of continuous improvement, best practices and highly protocolised, from employee performance reviews to alignment of interests to each of the processes of the different business units.

In a world where every company uses a plethora of buzzwords to explain how its culture is different and superior to that of its competitors, it is difficult for us managers to separate the wheat from the chaff, and I am generally sceptical of such efforts. However, the evidence of recent years shows that in Atkore's case culture and management have been a real differentiator, and while it may seem more qualitative than other factors such as economies of scale, it is no less important (in Helmer's terminology, such a competitive advantage would fall under the rubric of "process power").

In addition to an excellent track record of value creation in recent years, there are several macroeconomic tailwinds that should support Atkore's business over the next decade. In particular, the electrification of the economy and data centre construction should be two trends that support the company's growth. At the same conference last year, the management team stated the following in this regard:

“Yes, so I think data centers is probably one of our more product-dense applications. That's because it certainly starts with PVC in the ground. If you look at a data center and the amount of power that goes into a data center, the amount of cabling, the cable management, and so on and so forth in a data center, I'm pretty, I'd say content-rich for us. We've always been consistently felt like that's a strong market. I do believe that the AI situation will prompt maybe even more demand there. I think the other thing that's interesting to me is just the amount of power that's being used in these data centers increases. It seems like every generation, anytime you have more power, more connections and all that, you will see that represented in our amount of product that we will build in that data center.”

Finally, Atkore's valuation is very reasonable. Given that the company was a clear beneficiary of the supply chain problems during the pandemic, the market has doubts about its earnings power in a normalised environment. In these cases, as was the case with homebuilders or recreational vehicle manufacturers two years ago, I think it is easier to get a sense of this capacity by focusing on the company's return on capital employed (a ratio) rather than on absolute profits. The reason for this is that *profits in absolute terms are a function not only of the margins the company is making, but also of the amount of capital it needs to make those margins*. Given that Atkore has almost doubled its net operating assets (NOAs) between 2019 and 2023 (from almost \$1bn to \$1.8bn), an analyst will struggle to disentangle

how much of the earnings growth is due to asset growth and how much is due to the pandemic effect (margins).

At the end of June, the stock was trading at around \$130 per share, implying an enterprise value (EV) of \$5.2 billion, which, given its NOAs of \$1.8 billion, means that the company trades at an EV/NOA multiple of 2.8x, which seems high given that it is an industrial business with little differentiated products. However, the company's return on net operating assets (RNOAs) from 2019 to 2023 are 17%, 20%, 65%, 69% and 42%, respectively. Assuming RNOAs in the 20-25% range and very modest growth, the implied returns for buying at these prices should be in the double digits (10-15%) over the next few years. Given the company's minimal debt on the balance sheet, the excellent management team, the growth opportunities (especially inorganic) and the long-term predictability of the business (the nature of the business will remain essentially the same in a decade), I believe Atkore is one of the best opportunities in the US market right now and should be able to create value at a much higher rate than I expect the stock indices to over the next few years.

Major divestments during period

In line with previous periods, we made few divestments in the first half of the year. In particular, we sold Micron, SK hynix, BFF Bank and Elevance. With the exception of BFF, we realised capital gains on all of them, although our experience with the memory manufacturers and Elevance could not have been more different. Elevance has continued to execute its business plan in the face of adverse conditions in the industry in which it operates (the share price of several Medicare management companies has fallen sharply in recent months due to lower than expected fees and higher than expected costs) and as a result the share price has reflected the company's strong performance over the past year.

Our experience with memory manufacturers has been the opposite. After expecting a rationalisation of capex by the three manufacturers given the oligopolistic structure of the industry, the capex in 2020, 2021 and 2022 was exceptionally high, leaving all three companies in a vulnerable position when the memory cycle turned at the end of 2022.

While share prices are now being rewarded because such companies are seen by "investors" as "proxies" for investment in AI, the truth is that *in the long run the fortunes of all these stocks will be determined not by the amount of final demand that comes from AI servers, but by the capex that Samsung, SK hynix and Micron ultimately allocate to meeting that demand.*

Given that, in my view, capex levels did not fully normalise at the end of the last cycle (Micron's capital intensity in 2022 was still a whopping 40% of sales), and that companies are already announcing major additions to their capex plans, I very much doubt that the next cycle will see an average return on net operating assets of 15%, as has been the case over the last decade.

At the time of writing, Micron is trading at an EV/NOA of 3.5x.

As always, I thank you for your confidence and support and will be happy to answer any questions you may have.

Nullius in verba,

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LEGITIMACY: Legitimate interest in keeping you informed as a client and/or user.

ASSIGNMENTS: Not contemplated. **CONSERVATION:** During the contractual relationship and/or until you ask us to cancel the commercial relationship and during the periods required by law to attend to possible responsibilities once the relationship has ended. **RIGHTS:** You can exercise your right of access, rectification, deletion, portability of your data and the limitation or opposition in the email of the person responsible. In case of divergence, you can file a complaint with the Data Protection Agency (www.aepd.es).