BrightGateCapital
INVESTMENT~INTELLIGENCE

Interim letter to the co-investors of the BrightGate Focus Fund
1st half of 2025

July 8th, 2025, Madrid

"We have a liquid stock market which is two things at once — it's a place for people who are doing long-term investment rationally to go and make their transactions, and it's a place for another bunch of people to do casino gambling. We mix them up totally. It's an absolutely insane thing for the country."

Charles T. Munger: Singleton Prize for CEO Excellence Conference 2022.

Dear co-investors,

The Fund closed on 30th June with a NAV (institutional class) of 1.826,4, representing a return of -2,5% over the six-month period, compared with 6,2% for the S&P500, 9,5% for the MSCI World and 4,5% 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 (Euribor + 700bps), 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.

During the first half of the year, the Fund underperformed against the three aforementioned indices. This discrepancy is largely due to the substantial depreciation of the dollar against the euro, *one of the most significant since the introduction of the single currency*, and the subsequent impact on our dollar-denominated equity positions. The remainder of the difference is simply due to the modest performance of our main positions, as I will explain below. Although six months is a short period during which valuations can fluctuate randomly, I am disappointed not to be able to report better news. What has remained unchanged during this time is my conviction in our companies. On the one hand, they have continued to execute their business plans remarkably well, and on the other, they are trading at very reasonable valuations, unlike many (most?) other segments of the market.

The following quote, which is supposedly attributed to Lenin, accurately captures the intensity of recent months: "There are decades where nothing happens; and there are weeks where decades happen." In the first months of its term, the newly elected Trump administration has sought to embody this statement. It started a trade war with the rest of the world in early April, the outcome of which is still unknown; it has promoted the use of cryptocurrencies and stablecoins; it has tightened immigration policies; it is preparing measures to relax banking regulation; and, as I write these lines, it has just passed a new budget, the "Big Beautiful Bill", which is estimated to add $3.3 trillion to the US government debt over the next decade – equivalent to an additional annual deficit of 1.5% of GDP. Given that the United States already has one of the largest fiscal deficits in its history, aside from periods of financial crisis or war, *this spending increase will have a significant impact on economic activity and, as I will discuss in my next letter, on the profits of the US corporate sector as a whole.*

The legislative flurry described above is remarkable not only for the dizzying pace at which it was approved, but also for the way it has been implemented which, to put it generously, has been sloppy, with little or no consideration for the inevitable second (and third) order repercussions that occur when measures are introduced into systems that are as dynamic, nonlinear and multivariable as today's economies. Even worse, many of these measures have been designed solely to favour Trump's supporters, including his family and business associates, to the detriment of the public interest.

Despite the above, financial markets have behaved as if none of this ever happened, driven to a large extent by the aforementioned fiscal deficits, the (still) large central bank balance sheets, and interest rate policies outside the US that have turned expansionary again for the first time in years. Furthermore, during the semester, we have once again witnessed several of the signs of "irrational exuberance" similar to those seen in 2021. Unlike back then, when SPACs were the asset of the moment, the most paradigmatic examples now are cryptocurrencies and the so-called bitcoin treasury companies, entities whose only "business plan" is to accumulate bitcoin and pray that the market will value them above their NAV– thus enabling them to sustain an endless cycle of new issuances (equity, preferred shares, or convertibles). The speculative fever doesn't stop there, extending also to companies involved in artificial intelligence, quantum computing, and (drumroll) SPACs once again. Yes, you read that correctly: the SPAC market is back in vogue, and in the first half of the year [we've seen volumes] far exceeding those reached in 2023 and 2024.

Judging by what we've seen, Mark Twain was probably overly optimistic when he coined the famous phrase, "History doesn't repeat itself, but it rhymes", and he should have specified instead that, in Wall Street, people apparently aren't in the mood for rhymes.

Before discussing the latest developments in our investments, I would like to use this semester's letter to explain why certain speculative securities, known as "lottery-type" assets in the behavioural finance literature, exert such a powerful pull on many investors, especially retail ones. This reflection is particularly timely, given *today's sky-high valuations in Western equity markets, which are not only based on the Mag-7, but also on the myriad companies mentioned above that trade at valuations utterly disconnected from reality*.

Unlike the Mag-7, these companies have an explosive combination of fragile (or non-existent) business models, abusive use of 'pro forma' metrics and openly dishonest management teams. While it is impossible to predict when this cycle of euphoria will end (markets are "computationally irreducible" and their behaviour cannot be predicted in advance, as I explained in [my previous letter]), the outcome for most of these securities will mirror the one experienced by SPACs in 2021.

Whether these outbreaks of irrationality will become increasingly frequent or if we are simply experiencing a completely idiosyncratic episode born of a confluence of unique forces is open to debate. Although I tend to believe the latter (anchored in the simple, maybe simplistic, idea that there is nothing new under the sun in financial markets), in a [recent paper, Cliff Asness argues for the former. He maintains that equity markets have grown progressively less efficient over the past three decades thanks to rising indexing, prolonged low interest rates and the proliferation of social networks, which transform the Galtonian "wisdom of crowds" into a "madness of crowds".

Regardless of whether Asness is right or not, the following Buffett remark is very *apropos* for the current situation: "The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs".

Lottery-type stocks and prospect theory

Last year, I wrote about one of the most significant contributions to behavioural finance, Kahneman and Tversky's prospect theory, which was first introduced in 1979, and how this theory has several important applications in asset management.[1]

As a refresher, prospect theory rests on three complementary propositions. Firstly, people do not evaluate outcomes in absolute terms but in relative terms, using a reference point from which "gains" are measured if the change is positive relative to that point, or "losses" if the change is negative. Secondly, we subjectively value one unit of gain less than one unit of loss – we experience losses more intensely than gains, a phenomenon known as "loss aversion." And finally, we become conservative (or "risk-averse") within the domain of gains, but we turn aggressive (or "risk-seeking") when facing losses, driven by the urge to recover what has been lost.

This simple conceptual framework helps us to understand many behaviours of portfolio managers that would traditionally be considered irrational, such as the use of valuation multiples based on inflated metrics (highlighting the importance of reference points), selling winning investments while holding on to losers (we're risk-averse and eager to lock in gains in the domain of gains), and maintaining excessively short investment horizons (a phenomenon known as "myopic loss aversion").

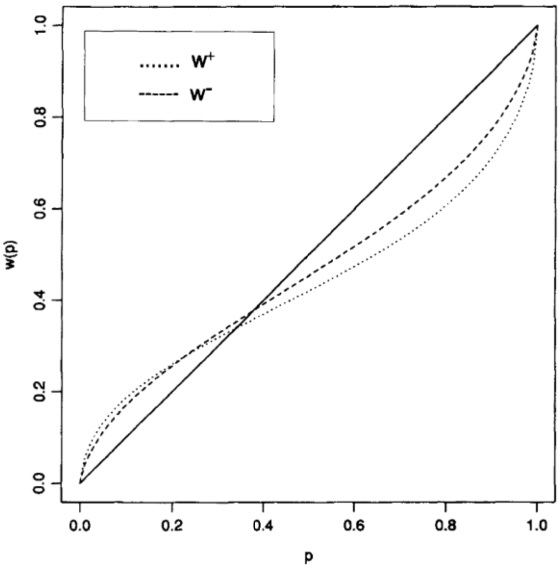
In 1992, the Israeli duo modified one element of prospect theory – this extension was dubbed "cumulative prospect theory," a name that, to be frank, is rather unattractive. The novel component suggests that people behave differently depending on whether an event's probability is high or low. In the former case, individuals act as the original theory predicts, risk-averse in the domain of gains and risk-seeking in the domain of losses; *however, when probabilities are low, people behave entirely in reverse, being risk-averse in the domain of losses and risk-seeking in the domain of gains.*

What's the fundamental intuition behind this? It has to do with how people form an internal sense of an event's probability distribution. Kahneman and Tversky state that *when making a decision, people don't carry the full objective probability distribution in their heads, but a spectrum of subjective probabilities.* They also propose that we tend to underweight high probabilities (for example, we "feel" a 99% chance as closer to 95% than to 100%), while overweighting low probabilities (we "feel" a 1% chance as closer to 5% than to 0%). Finally, they propose that when probabilities lie in a "grey area" (roughly the 40–60% range), we

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

become largely insensitive to small changes – we hardly distinguish, say, a 45% chance from a 55% one.

This way to estimate probabilities is called the "probability weighting function," and graphically it takes the following shape:



Probability weighting function according to cumulative prospect theory. Source: Tversky, A., Kahneman, D. (1992). Advances in Prospect Theory: Cumulative Representation of Uncertainty. Journal of Risk and Uncertainty, 5(4):297-323.

The horizontal axis represents the objective probability of the event, while the vertical shows our subjective estimate. Compared to a straight line, where our estimates would exactly match the objective probabilities, we can see that the curved line lies above the straight line when the probabilities are low (we overestimate the likelihood of rare events) and below the straight line when the probabilities are high (we underestimate the likelihood of almost certain events). At the midpoint of the graph, the curve flattens to reflect our insensitivity to changes in medium probabilities – we are relatively indifferent to whether an event has a 45% or 55% chance of occurring.

This refinement of prospect theory elegantly explains several real-world behaviours that might otherwise seem contradictory. For instance, a person may wish to purchase an expensive insurance policy for highly improbable events and, simultaneously, purchase a lottery ticket; people with a preference for a 0.1% chance of winning 5,000€ over a guaranteed gain of 5€ (risk-seeking in the domain of gains when probabilities are low), yet a preference for a guaranteed loss of 5€ over a 0.1% chance of losing 5,000€ (risk-averse in the domain of losses when probabilities are low).

In financial markets, *the most significant implication of cumulative prospect theory is that securities with highly asymmetric return profiles, i.e. those with a high probability of total loss and a low probability of substantial gain, should generally be expensive and have poor historical returns*. These securities, known in the literature as lottery-type, usually trade at a significant premium to their intrinsic value because investors overvalue the implicit optionality, willingly paying more than they should for the small chance of a substantial payout while simultaneously underestimating the real likelihood of loss.

What are some of these assets? The gallery of horrors is quite extensive, but for illustrative purposes, the academic literature has identified several examples: initial public offerings

(IPOs),[2] over-the-counter (OTC) stocks, shares of companies undergoing turnarounds,[3] shipping companies[4] and *growth* stocks with weak fundamentals[5]. These tend to exhibit highly asymmetric return distributions and have historically delivered poor returns.

For example, one study of shipping stocks shows that these stocks delivered the lowest average return of all the sectors analysed, while also exhibiting the highest volatility. This clearly contradicts the conventional finance mantra that "higher risk should lead to higher returns".

Industry Classification	Panel A: Daily Statistics Obs N	Mean (%)	Stdev (%)	Mean/Stdev N
Shipping	7,100	0.02	2.04	0.01
Telecom	7,100	0.07	1.38	0.05
Energy	7,100	0.09	1.77	0.05
Cons Durables	7,100	0.07	1.23	0.06
Utilities	7,100	0.05	0.88	0.06
Chemicals	7,100	0.08	1.15	0.07
Manufacturing	7,100	0.08	1.16	0.07
Shops	7,100	0.08	1.06	0.08
Buss Equipment	7,100	0.11	1.31	0.09
Cons Non-Durables	7,100	0.08	0.9	0.09

Daily statistics by sector, 1989-2017. Source: Makrominas, M. & Marcoulis, S. (2023). Shipping Stocks as Lotteries, Maritime Policy & Management, 50:5, 651-667.

Interestingly, a similar pattern emerges in the world of credit: riskier debt instruments do not deliver higher long-term returns. Although no academic study has rigorously linked this empirical pattern to cumulative prospect theory, the observation remains striking and it is easy to theorise that investors tend to underestimate the probability of default in the case of highly risky credits, which resemble lottery-type assets.

For example, some years ago, Verdad Advisers published an article showing that *returns from credit risk do not follow a linear function; instead, they peak around the BB rating tier and then decline as credit ratings fall further*. Despite the high volatility (and significant losses) associated with B- and CCC-rated debt, investors have not historically been rewarded with higher returns for taking on that additional risk:

	AAA	AA	A	BBB	BB	B	CCC
Average Yield	4.3%	4.3%	4.8%	5.6%	7.1%	8.9%	14.7%
Realized Return	5.1%	5.2%	5.4%	6.0%	6.9%	5.8%	6.8%
Volatility (StDev)	5.0%	4.4%	5.3%	5.6%	7.1%	8.9%	14.3%
Return/Risk	1.0	1.2	1.0	1.1	1.0	0.6	0.5
Max Drawdown	-9.3%	-11.3%	-18.1%	-17.2%	-25.1%	-34.0%	-48.6%

Risk and return by credit ratings, 1997-2019. Source: Verdad Advisers, 2019, Fool's Yield.

[2] Green, T., & Hwang, B. (2012). Initial Public Offerings as Lotteries: Skewness Preference and First-Day Returns. *Management Science, 58*(2), 432–444.
[3] Campbell, J., Hilscher, J. and Szilagyi, J. (2008), In Search of Distress Risk. *The Journal of Finance, 63*: 2899-2939.
[4] Makrominas, M. & Marcoulis, S. (2023). Shipping Stocks as Lotteries, *Maritime Policy & Management, 50*:5, 651-667.
[5] Zhang, X.-J. (2013). Book-to-Market Ratio and Skewness of Stock Returns. *The Accounting Review, 88*(6), 2213–2240.

Returning to the discussion in the context of equities, there is another important implication of how we weigh up probabilities when investing. Since lottery-type stocks tend to be overpriced, this also means that stocks with a high probability of modest gains and a low probability of total loss tend to trade at a discount. In these cases, investors tend to overestimate the small chance of loss and underestimate the likelihood of favourable outcomes. History suggests that this hypothesis is reasonable; these "boring" stocks have delivered better returns with lower volatility, what the literature refers to as the low volatility anomaly.

In last year's letter, I argued in favour of using base rates as a starting point for a rigorous methodology to identify potential investments where the probabilities are in our favour. As I have hopefully made clear in previous letters, as well as in the comments in the following section, the profile of the investments that make up our portfolio deliberately avoids the speculative characteristics of lottery-type stocks, and I am fully convinced that the long-term results of these different investment approaches will reflect this important distinction.

Structure of the portfolio and updates on our main investments this semester

As of the end of June, the portfolio structure is as follows: 66.6% is invested in long-term equities, 6.1% in special situations (through our position in Liquidia), 14.6% in fixed income, 3.7% in preferred stocks via our position in Freddie Mac and 9% in cash. This rises to 14% if very short-term government bonds are included. The three high-yield bonds that comprise our fixed-income portfolio offer a yield to maturity of 9% (after the currency hedging costs) and have a duration of 3.

In terms of sector composition, the main sectors in which we are invested, in order of significance, are: cyclical consumer (34.8%), financial (15.9%), non-cyclical consumer (12.5%), energy (9.8%) and industrial (9.5%). The businesses within each sector are highly diverse. With the exception of our exposure to the auto dealership sector, in which 12% of the fund is invested, the remainder of the portfolio is diversified across a wide variety of industries.

Next, I will discuss the most notable developments in our main long-term equity investments that have occurred during the semester. For investors less familiar with any of these positions, the details of the respective theses can be found in past year-end letters:

Northeast Bank (NBN:US)

Once again this quarter, Northeast Bank (NBN: US) is the largest holding in our fund. The stock's performance over the semester has been very subdued, with returns close to zero, mirroring that of most regional bank stocks. Following Trump's victory in November, "investors" betting on this theme drove up these shares aggressively, expecting widespread banking deregulation. However, as the months passed, investor enthusiasm waned, bringing these stocks back down to their election day levels.

Needless to say, *the thesis behind Northeast is entirely different and has nothing to do with hypothetical regulatory changes*. Despite maintaining a conservative balance sheet, the bank remains extraordinarily profitable, with a year-to-date ROE of 18% and approximately $870 million in capacity to purchase or originate additional loans – a substantial amount compared to the $3.7 billion it had at the end of the last quarter. Given that the shares are trading at 1.5x P/B and 8x P/E, I am convinced that returns over the coming years will be exceptional, and more importantly, with very low risk.

I would like to mention here that *I am considering increasing our exposure to the theme of "regional banks temporarily penalised, yet with excellent returns and top-tier management teams" in the coming months.*

Auto dealers (ABG:US, AN:US)

Over these months, our two positions in the dealership industry, Asbury Automotive (ABG:US) and AutoNation (AN:US), experienced significant volatility as a result of the tariff announcements and their potential impact on the industry's value chain. While both stocks have recovered the losses incurred during the spring, it is too early to determine the long-term impact of these policies on dealerships.

On the one hand, although tariffs may provide a short-term boost to dealerships' used-car inventories, the expected rise in used-car prices means that lower sales volumes will hurt these companies' asset turnover over the medium term. Additionally, the revenue stream from vehicle financing and insurance, which carries margins close to 100%, will shrink since it depends on the number of units sold. However, the drop in sales should benefit the repair and parts business, as consumers extend their maintenance cycles, which will partially offset the decline in new and used car sales.

Another significant event during the semester was Asbury's acquisition (although the deal is still pending completion) of The Herb Chambers Companies, the fourteenth largest private dealership group in the country with 33 stores primarily in New England. Although the deal was struck at a reasonable multiple of 0.46x sales, it is not materially different from Asbury's own trading multiple. This makes a share-repurchase policy, like the one AutoNation is executing, a more sensible strategy as it carries lower risk (repurchases lack the integration risk inherent to acquisitions) while delivering comparable returns under both approaches.

The market is already beginning *to factor in the risks associated with an acquisition-driven strategy*, such as Lithia's high-multiple deals post-pandemic. This is evident from the fact that AutoNation now trades at a premium to both Asbury and Lithia. Personally, I agree completely. While I'm confident that Asbury will bring some of its famously excellent operational expertise to the Herb Chambers locations, I believe those dealerships are already highly productive, with average sales per location of around $88 million.

In any case, Asbury still trades at a P/B ratio of 1.4x (EV/NOA of 1.2x). Even assuming ROEs in the 15–20% range given the dilution brought by recent acquisitions, that should deliver 13–15% returns assuming only modest growth going forward.

Kaspi (KSPI:US)

In contrast to dealership stocks, the news over these past few months couldn't have been more positive for Kaspi.

Firstly, it is continuing to execute its ambitious growth plan in Kazakhstan, with notable progress in the travel sector, its grocery business and the car marketplace. While its payments business already has high market penetration, the online commerce segment is expected to generate strong, profitable growth in the coming years.

However, the most significant news has been Kaspi's acquisition of a 65% stake in Hepsiburada ("Hepsi"), Turkey's second-largest online commerce platform. Representing 5% of Kaspi's market capitalisation at the time of the announcement, this move is an excellent decision, with huge optionality given the immense growth potential, given Turkey's population of 85 million – four times that of Kazakhstan. This acquisition should put to rest any doubts about Kaspi's future growth prospects.

Following the acquisition of Hepsi, Kaspi also acquired Rabobank's operations in Turkey. The rationale of this deal was to accelerate the process of obtaining a banking licence (Rabobank's Turkish operations were minimal) and begin integrating the banking and online commerce businesses in Turkey as soon as possible.

Although the level of competition in Turkey far exceeds that in Kazakhstan, and I do not anticipate ROEs approaching those that Kaspi has historically achieved, *the Turkish opportunity is potentially very lucrative*. I am fully convinced that Mikhail and the rest of the Kaspi team will demonstrate the same level of commitment and operational excellence as they have to date. The company's customer obsession, culture of continuous innovation and experience in Kazakhstan will secure a dominant market position in Turkey over the coming years.

Nobody could have guessed any of the above by simply looking at the stock's price evolution, which has fallen by 9% since the beginning of the year. The share has presumably been penalised by investors who are concerned about the slowing growth in Kazakhstan, the downward revision of this year's earnings growth forecast (from 20% to 16%), and the lack of clarity surrounding the end of the war between Russia and Ukraine. Although Kazakhstan has nothing to do with the conflict, it is clear from blogs and other online commentary that "investors" trade the company's shares as if they were a proxy for ending the war. Finally, the temporary suspension of the dividend to finance the Hepsi acquisition forced many dividend-focused funds to sell their holdings, further exacerbating the downward trend.

With a market capitalisation of $16.5 billion and expected earnings of around $2.3 billion this year (assuming 15% growth on last year's KZT 1.1 trillion earnings and an exchange rate of 520 KZT/USD), the P/E ratio is below 8x. This clearly implies that a reasonable outcome can be achieved from these levels without everything going perfectly. Following the Hepsi acquisition and the restoration of capital levels after the summer, the company announced that it would reevaluate its shareholder remuneration policy, *opening up the possibility that share buybacks will take precedence over dividends for the first time*. Although this wasn't historically feasible due to minimal liquidity in the London-listed securities, the current liquidity on Nasdaq provides the volumes needed for large-scale repurchases. Assuming the share price remains unchanged, I'm confident that management will act decisively to address this inefficiency. In the meantime, the successful execution of the business plan in Turkey should provide another catalyst for the shares in the short and medium term.

Garrett Motion (GTX:US)

There have been no major developments, so the update on Garrett will be brief. Recent results continue to demonstrate that Garrett still generates very high returns with stable margins in an environment where margins have not normalised yet for automotive suppliers. Despite Oaktree and Centerbridge continuing to unwind their positions as planned, the stock has performed well this year.

The inclusion of Garrett in several stock indices could be another significant short-term catalyst for the share price. However, I should mention that any short-term price gains in Garrett's case would have a negative impact on our long-term results, given the company's aggressive share-repurchase programme – one of the most ambitious in our portfolio, alongside SLM. At current prices, I estimate that Garrett will be able to buy back over 10% of its outstanding shares each year. With returns approaching 20% at these levels, *the share buyback programme is obviously economically significant, and a fall in the share price would amplify its impact*.

In other words, I am confident that the stock will perform strongly in almost any possible scenario over the next three to five years. However, it is rational to defer those gains to the future in order to increase them rather than bringing them forward to the present and reducing them.

BRP Inc. (DOO:CN)

Of all our major positions, BRP has been the most volatile one this semester. The powersports industry has continued to post weak sales figures, and tariff tensions have directly impacted the company, given that it is a Canadian firm whose largest market is the United States and with several factories in Mexico. Although the stock experienced extraordinary volatility (at one point, losses reached 30%), it has recovered most of the losses it suffered in April and May, and year-to-date it is another of our companies with returns close to zero.

Despite the recent uncertainty, the thesis hasn't changed at all in the last few months, and, in fact, there are some reasons to feel slightly more optimistic – hope springs eternal![6] Firstly, inventory levels in the distribution channel are now close to normalising, meaning that, going forward, final sales volumes will align with companies' production volumes. BRP has expressed optimism for the first time in several quarters that we should see a recovery in the sector in the second half of the year.

Secondly, BRP's exposure to tariffs is limited, as both its products and components are largely exempt under the USMCA free trade agreement between the US, Canada and Mexico, which came into effect on 1 July 2020 – and was, ironically enough, signed by the previous Trump administration! One of BRP's main competitors, the US-based company Polaris, has been affected by components imported from China.

As I mentioned, the situation remains fluid, but *there is a strong possibility that BRP will emerge from these developments stronger and continue to gain market share in the next sector cycle*. In my view, the shares are undervalued, trading at a modest EV/NOA of 2.3x,

[6] The thesis was outlined in detail in the appendix to the 2024 year-end letter, and for reasons of space, I won't repeat it here.

receiving zero credit to the company's outstanding historical returns (with RNOAs close to 40%), dominant position in all its markets, experienced management team and exceptional product portfolio.

Main additions to the portfolio

During the first half of the year, the Fund made only four new additions to the equity part of the portfolio: Ingles Markets (IMKTA:US), Pulte Group (PHM:US), Stella-Jones (SJ:CN), and Universal Logistics Holdings (ULH:US). Additionally, in the fixed income portfolio, we acquired the bonds of DNO and Pearl Petroleum, both offering yields above 8% in euros.

While the positions in Ingles Markets and Stella-Jones are small (representing less than 2.5% of the Fund each and intended as "starter positions"), the investments in PHM and ULH are more significant due to their larger weightings. Below, I will briefly present the investment theses behind both companies.

PHM is the third largest homebuilder in the US, having delivered 31,000 homes in 2024 alone. It was the only new investment we made amid the tariff panic in April, although its share price had already fallen by more than 30% since October due to the U.S. housing market's slowdown in recent quarters.

My investment thesis for PHM remains the same as it has been since we began investing in this sector back in 2022. First, the residential construction business is profitable throughout the economic cycle: the main publicly traded companies routinely achieve returns on net operating assets (RNOA) above 15% – and above 20% in recent years due to the lack of supply in the existing home market. Second, the risk of technological obsolescence is minimal, which gives me confidence that this business will continue to exist in a fairly similar form a decade from now. Third, as in other developed economies, there has been a housing supply deficit since the Global Financial Crisis, meaning the sector should face a favourable environment once the current affordability crisis improves. Fourth, PHM has the strongest balance sheet in its history, with net operating assets (NOA) of around $13bn versus a net financial debt of less than $1bn. This, along with the company's move toward a capital-light model, should make it resilient during the most difficult phases of the economic cycle.[7]

Finally, with an EV/NOA of 1.8x, PHM is trading at a level that provides a margin of safety, even if RNOAs revert to 17% – compared to levels above 24% that have been reached in recent years.

On the other hand, ULH is a new position that began in March. ULH is a logistics company operating in various segments, the most important of which in terms of operating profits is contract logistics for third parties, primarily industrial and automotive companies. ULH's services in this segment include materials handling, goods consolidation, sub-assembly, dock management, and container logistics. The other major ULH's vertical, the intermodal segment, is currently making losses due to the industry-wide recession resulting from the normalisation of supply chains following the bottlenecks caused by the pandemic – and which led these companies to make substantial profits in 2021 and 2022.

[7] The share of lots controlled through options increased from 26% in 2014 to 56% a decade later.

The contract logistics business is relatively attractive, offering medium- and long-term contracts. For customers, the most important factor is service quality, since companies such as ULH are responsible for managing all processes, so this means that a stoppage due to a change of suppliers would be an unacceptable risk for customers. Price is the second consideration in negotiations. Although not high, ULH's historical RNOAs have been stable, hovering around 8-12%. Given the business's historical financial leverage, this has produced ROEs of around 20%.

The risks of the thesis are not only financial leverage, which I believe is manageable but slightly higher than that of our other investments, but also an unfavourable cycle that is longer than expected as a result of the second derivatives of tariffs. In addition, there is a significant risk that the family controlling the company could launch a delisting bid at a very low price. However, I believe that these risks are more than offset by the business's characteristics, the importance of logistics assets in the United States for automotive companies due to reshoring (at least over the next three years) and the valuation, given that the shares are trading at 1x in terms of both EV/NOA and P/B.

Main divestments during the semester

The main divestments made during the first six months of the year were Mr Cooper, the OSB Group and the Vistry Group. The reasons for the sale differed in each case. In the case of Mr Cooper, the company is going to be acquired by Rocket in an all-stock deal. Given that I did not want exposure to Rocket, and that the premium offered was fairly close to a reasonable valuation of Mr Cooper, I considered it to be a good time to sell. OSB has been in the portfolio for around two years (it was acquired shortly after accounting problems arose due to mark-to-market issues with the variable interest portion of mortgages). Although it has been a volatile journey, the dividends received and the increase in the multiple (from a price-to-book ratio of 0.6x to 0.9x) have made this investment profitable. While I am likely leaving “some money on the table”, OSB's diversification into other areas seems marginally riskier than the traditional buy-to-let business to me. Finally, I sold Vistry due to a lack of conviction in the thesis. Although the losses were minimal, the acquisition was clearly a mistake on my part.

The main fixed-income sales were American Coastal, Genworth Financial and Murano. The first two bonds have performed excellently since they were purchased. However, they are now trading at yields that are insufficient for the Fund's return targets. Murano bonds, on the other hand, were purchased at the end of 2024, and a radical change in the investment thesis since then meant it was preferable to sell the bonds at a loss of 25% (without taking into account the accrued coupon) within a few months, rather than holding them in the portfolio. Situations like this, involving fraud (the management team promised to open the hotel expansion by the end of 2024 during the September roadshow, but in March 2025, we learned in a brief comment that the opening would be delayed until the end of 2025), are very rare. Over time, I have learned that it is better to accept a loss than to remain invested with a management team of this kind. Fortunately, the bond's first lien on a real asset meant that the loss was limited.

Financial Statement Analysis for Value Investing

Finally, it would be unforgivable to omit mention of Stephen Penman's visit to Madrid at the end of June. Stephen Penman is the George O. May Professor at Columbia University and the director of the Master's programme in Accounting and Fundamental Analysis. He was in Madrid to present his recently published book, *Financial Statement Analysis for Value Investing*, at two different conferences. He also spent a full morning at our offices with other staunch followers of his approach, resolving several of our accounting and valuation doubts. Stephen is not only an excellent person, but also a true believer in what he teaches, and his infectious enthusiasm makes the seemingly dry subject of financial accounting entertaining and accessible when applied to company valuation.

The investment process for the funds we manage at BrightGate would have been different, and certainly inferior, had we not read Stephen's second book, *Accounting for Value*, back in the winter of 2013. In a world where markets completely arbitrage any edge one has over them (although, as we have seen, Clive Asness believes that markets are becoming less efficient), *understanding the organic interaction between accounting and company valuation through the lens of Stephen's framework is an undeniable advantage over the simplistic approach used by most market participants* – including institutional investors.

I would highly recommend that all our investors read Stephen's latest book, *Financial Statement Analysis for Value Investing*. Although Stephen himself acknowledges that it is more complex than traditional value investing books, readers will be pleasantly surprised by the clarity and consistency of his approach. The numerous exercises scattered throughout the book also help readers to internalise the main features of this approach. In the current market climate, this book is particularly pertinent, especially for investors who base their investment process on an in-depth study of fundamentals. Those who would like a preview of the book's ideas can read my detailed review for the CFA Institute's *Enterprising Investor* blog, as well as my more introductory review for El Economista.

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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