



Dear Friends and Investors,

The core portfolio for Massif Capital was up 3.1% net of fees during the second quarter of 2021. Year-to-date, the portfolio has returned 6.7%.

PORTFOLIO ATTRIBUTION¹

The dispersion of daily returns for the core portfolio settled down significantly in the second quarter², along with a continued decline in daily liquidity for many positions following a seemingly frantic level of trading that grew from October 2020 through February 2021.

Our mining investments continue to outperform, generating an aggregate 4% return to the portfolio. Notable contributors include Ivanhoe Mines, Kazatomprom, and Alphamin Resources. Our allocation to utilities, comprised of positions in AES, RWE, and Polaris Infrastructure, dragged on returns, contributing -0.74%. Equinox and Vestas had particularly challenging quarters. Both positions are discussed below in further detail.

Top 5 Positive Contributors	2nd Qtr Contribution	Current P&L*	Bottom 5 Contributors	2nd Qtr Contribution	Current P&L*
Ivanhoe Mining (IVN)	2.74%	287%	Vestas (VWSB) [^]	-1.21%	50%
Kazatomprom (KAP)	1.43%	99%	Equinox (EQX)	-0.81%	2%
Alphamin (AFM)	1.18%	47%	Lithium America (LAC)	-0.80%	462%
Altius Minerals (ALS)	0.87%	28%	Polaris Infrastructure (PIF)	-0.32%	35%
Equinor (EQNR)	0.56%	70%	RWE (RWE)	-0.30%	-5%

*As of 7/12/2021

[^]Position Closed on 6/11/2021

Stretching back to the beginning of 2020, we are fortunate to have many of our positions exceed our time-adjusted performance expectations. This is a great situation to be in but not one without complications. Nearly 100% of our underwriting is concerned with fundamental changes to a business. On average, fundamental company change is a multi-year process. Upside volatility that takes stock prices to our expected fundamental value raise challenging questions about sell decisions. Do we sell because the firm's price has hit our expected value even though few of the fundamental factors necessary to justify that value have yet to unfolded?

Complicating matters further, many of our businesses are cyclical, making them behaviorally challenging to hold for extended periods. As such, we need to be willing to handle periods of higher multiples and accept drawdowns in route to a successful secular thesis.

One of the ways we can structurally build in patience is to measure the earnings power of the portfolio constantly.³ For example, in the calendar year 2020, AES saw an 18% gain in its share price. More than 100% of that price appreciation was attributable to pricing multiple expansion, as profit margins and top-line revenue contracted. However, AES also grew its per-share earnings power by roughly 25% over the course of 2020.

We do not find the multiple on AES's earnings particularly egregious today, but we are also very confident that AES is compounding their earnings power sufficiently such that they will grow into and eventually outpace any near-term higher multiples. It is one way we have the patience to hold the security through periods of oscillating market multiples and to separate price from performance.

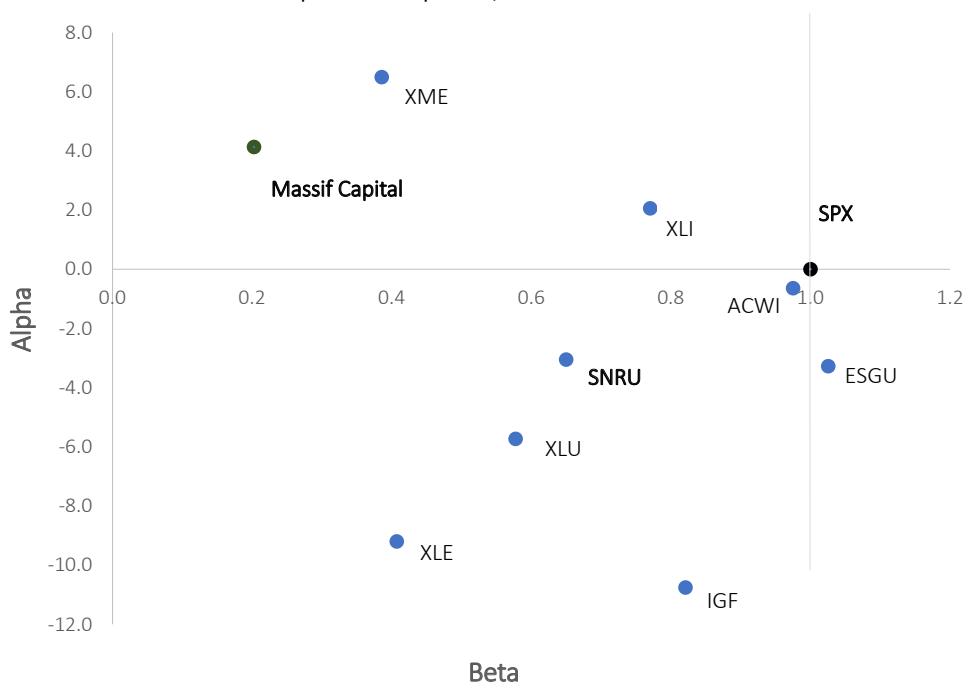
At present, 58% of the portfolio's gross long exposure is comprised of mature businesses generating cash that is either reinvested or returned to shareholders. Just under half of that cohort saw annual returns in 2020 attributable to multiple expansions. However, these businesses have generated a weighted average⁴ 16% increase in their earnings power over the same period. The growth in earnings power we are observing today is not uniformly distributed, and we expect higher turnover within the portfolio over the next six months but remain positive on many positions despite solid performance over the last year.

The remainder of the gross long exposure are companies whose value, we believe, will be unlocked from an event-driven catalyst or monetization of their balance sheet.⁵ Collectively, our hypothesis for the monetization of these assets extends through to 2025, with most of them anticipated in the next two years. In the interim, the share price of these businesses reflects some percent expectation of future earnings or capital flows into otherwise relatively inelastic stocks. We can evaluate construction progress, we can re-examine the conditions for M&A activity, but we cannot neatly and empirically attribute the performance of the equity to market multiples or fundamentals.

We are comfortable holding 42% of our gross long exposure in this fashion, in part because we are paid to isolate unique asymmetric opportunities that require active management. It also means that it is rare for these positions to correlate amongst each other, which means the chance for volatile positions to become problematic due to cross-correlations is reduced. Lastly, the aggregation of highly non-correlated companies generates a differentiated return profile for the portfolio. Over the last five years, the portfolio has produced an annualized alpha of ~4% relative to major indices.

EQUITY RISK/REWARD (BETA/ALPHA)

Massif Capital Inception, June 2016 – Q2 2021



ERRORS OF OMISSION AND COMMISSION

Mistakes are inevitable in investing. Few things are more critical to long-term success than discussing mistakes and conducting regular postmortems.

We tend to be annoyed by errors of omission but find them easier to live with as they are mistakes that do not impair capital. Lost opportunities are nevertheless painful, particularly as research has a significant opportunity cost, and our job is to maximize return on capital.

Errors of commission tend to be more painful as they do (or can) impair capital. We have either added, subtracted, or re-arranged the capital at our disposal given a particular hypothesis which later proves to be the wrong call.

We mention this to discuss our exit from Vestas Wind Turbines in the second quarter. A position we sold for a gain of roughly 50% but could have sold earlier in the year for a gain closer to 100%.

This was an error of commission, but an interesting one that highlights the difficulty of sell decisions. In our opinion, sell decisions tend to be overlooked (or under-discussed) relative to the extensive focus on buy decisions.

By January 2021, the market had priced in a near-perfect future for Vestas. Consulting our notes at the time, our real-time evaluation consisted of the following conclusion: the price was within the range of one of our valuation scenarios. There was thus a path forward for Vestas to hit that market price. Moreover, the size of the position had not grown to the limits we tolerate before we needed to consider trimming.

Although there was nothing incorrect in that analysis, we failed to go back and check whether the scenarios underpinning that analysis remained valid; valuation scenarios, in essence, become assumptions we failed to re-validate.

We initiated a position in Vestas in 2019. Our thesis at the time was that the company was Tier 1 wind turbine manufacturer with a clear path towards achieving 8-15% compounded growth in wind turbine production volumes over the next 5-7 years. Their core markets were growing at equivalent growth rates, and their balance sheet afforded them ample flexibility should the need arise. Moreover, their services division with ~25% EBIT margins appeared, in certain futures, capable of growing from 30% of earnings to 60% of earnings over five years, which would swing the driver of total Group earnings from the stubbornly low-margin wind turbine manufacturing business to the high margin and reoccurring services businesses. Lastly, while Vestas remains a capital goods business, we thought it reasonable to speculate that they may enjoy a higher premium on their earnings should secular themes (read clean energy) persist.

This last point proved prescient as Vestas shot higher on a wave of ESG enthusiasm during the fourth quarter of 2020 and the first quarter of 2021. The price volatility to the upside caught us flat-footed, though, and we stumbled in our exit. We tend to set our valuation targets based on a collection of future scenarios with an attached probability; note it is a subjective probability based on a mosaic of qualitative and quantitative data. In the case of Vestas, this meant we believed that in roughly 35% of possible futures, the firm could evolve toward a business with a €55 per share value. A simplified version of scenarios at the time we put on the position was as follows:

Vestas Valuation Scenarios

Scenario	Price Target	Subjective Probability
Scenario 1	55	35%
Scenario 2	27	45%
Scenario 3	17	20%
Probability Weighted Value		34.8

As the price traded to and above our probability-weighted value, we anchored to the high valuation scenario despite the increased time horizon associated with the price target and thus the increased probability of downside price volatility all else equal. In short, we implicitly accepted a trade with diminishing capital gain returns, predicated on a longer time horizon, in which 65% of the possible futures we could foresee the unrealized capital gains would be impaired, and in 20% of the possible futures they would be significantly impaired. What we needed to do was reevaluate our subjective probabilities and re-weight/rework our scenarios considering new information and an evolving situation, producing an updated probability-weighted value.⁶

Vestas is a good business. But they are transitioning from a high-growth business to a mature growth business, and the economic profit they can capture per dollar of revenue will shrink. From 2016 - 2018, Vestas saw an average return on invested capital of 235%. Last year it was 28%. We do not find that return to be sustainable for a mature manufacturing business.

The market price, however, signals (implicit or otherwise) that the value extraction per unit of growth will persist. Working backward, if we assume that the company can hit their 10% EBIT margin goal and we use the market expectation for future capital expenditures, the current price implies a return on investment close to 20%, rather high for a maturing manufacturing business. Another vantage point that elicits similar uneasiness about market expectations is that the yield that sets the present value of forecasted cash flows equal to the current enterprise value (a theoretical measure of implied market discount rate) is less than zero.

We think Vestas will continue to grow. But we think earnings will increase less and pricing multiples will begin to contract shortly after, especially given that we now struggle to see a point at which the services business overtakes the manufacturing business as the firm's primary source of value creation. Looking at rolling five-year periods, normalized operating income margin is roughly 10% thanks to a period of uniquely high margins in 2016-2017. That is likely to drop next year as those early years roll-off. Longer-term, we see no evidence for sustained margins above 10%. As their asset base grows, average maintenance CAPEX will likely continue to increase, yielding lower adjusted earnings.

As the path forward to justify the valuation increased (by years), we concluded that holding the position was not prudent relative to the potential downside volatility. Particularly following first-quarter results by which our base case turned to underperformance for the calendar year 2021 relative to both market and management expectations.

Our errors occurred not in the upfront research but during the life of the position, an area of investing which we believe remains under-discussed in most literature, in part because it is so situationally specific. Sitting on a quick unrealized gain, we got caught playing with house money and made a bad call. Lessons include:

- 1) The importance of preparing to sell at the time you prepare to buy; asking the question, "Why will I sell this stock?" Many value investors may balk at this proposition. Still, we propose that preparing to sell is simply answering a question you will inevitably face, even if your ideal holding period is forever. After all, although we all look for positions we can hold for the long-term, how often do we find positions we can hold forever? We would argue it only happens a few times in a career (and potentially never).
- 2) The importance of reassessing an investment thesis on a drawdown, even when that drawdown occurs above your entry price.
- 3) The importance of refreshing valuation scenarios when understanding evolves. This is perhaps obvious, but an investor's understanding of a firm is continuously changing, and unless the investor tests their new knowledge by translating an updated mosaic of qualitative and quantitative information into target valuations, an investor is simply learning new things that they are not reflecting in their valuation estimate. They are assuming that new information is already embedded in their valuation estimate. One should ask if one's understanding has evolved,

how can that information be reflected in a valuation target constructed before achieving that understanding?

PORTFOLIO REVIEW

After a busy first quarter in which we added several companies to the portfolio, the second quarter was relatively quiet. We sold two positions and increased our holding in Adriatic Metals (ADT), doubling our position size from 3% to 6%. ADT is an Australian-listed junior miner currently developing a polymetallic silver mine in Bosnia Herzegovina and a zinc mine in Serbia. As the firm advances its projects, both have improved their long-term potential and have de-risked the assets disproportionately to the stock price move.

The business is fully funded through to a final investment decision, and we expect to receive the definitive feasibility study and news on financing in the next few months. Their polymetallic silver project could see construction complete by Q4 2022, with a ramp-up in production in early 2023. The present value of cash flows from that asset alone is worth roughly a billion USD relative to a current market cap of USD 370 million. ADT appreciated ~38% from our initial purchase price at the time we added to it, but increased daily liquidity and encouraging reports out of their underground mine plan presented us with an excellent opportunity to increase our position with a block of stock that offers a better risk-adjusted return, in our estimation, than our first purchase.

Although there was minimal movement in the portfolio's composition this past quarter, several firms we are invested in did experience noteworthy events.

Equinox: Our largest gold allocation, and a long-term holding, Equinox Gold has had a rough go of it in the markets lately. Despite our comprehensive review of the firms' operations and the market for gold equities, we are left somewhat puzzled by the fall in stock price. Admittedly, we would argue that the recent high it set during the first quarter of this year was too high relative to where the firm stood in its long-term evolution as a business, but it is now trading at levels that are equally incorrect on a fundamental basis but to the downside.

We believe that a mix of the gold price retreat and political risk at the firm's Los Filos asset have prompted investors to exit. At its current price, the firm's value is below that if Los Filos was removed from the firm's portfolio altogether. This is to say the market is pricing in not only an expectation that issues in Mexico are never resolved and that no gold is ever produced from the mine again, but that other development projects also go wrong.

Given the firm's management team and the history of operations at Los Filos and in Mexico more generally, we think the idea of Los Filos never producing gold again because one local community controls 2% of the land package upon which the mine is built is unlikely. Especially when other local communities surrounding the mine control significantly more of the land package, are happy with their relationship with Equinox, and want to get back to work.

Another issue for Equinox this past quarter that we found very interesting is a false news report released by several NGOs working around the firm's Aurizona gold mine in Brazil. During this year's rainy season, which straddles the first and second quarters, a naturally occurring pond on the mine site flooded and topped the pond's embankments, resulting in downstream flooding but no damage to any infrastructure or communities. NGOs reported the incident as a tailing pond break that resulted in a lack of potable running water in surrounding communities.

Undiscussed was the fact that it was not a tailings dam break, that the local communities only had ready access to clean potable water because Equinox helped service and maintain purification equipment that the government failed to service and maintain but was responsible for and that in the wake of this naturally occurring flooding, Equinox decided to pay for the build-out infrastructure to facilitate running water in all local communities,

where previously there had not been. We do not believe this event played a significant role in this quarter's sell-off, but we think it is an interesting and concerning event for investors. Just as investment firms engage in greenwashing, we believe the "brown washing" of firms by politically motivated third parties is a growing risk for economically critical but underappreciated industries. A gold mine may not be economically critical, but one could easily see the same accusations being laid at the feet of numerous other extractive industries.⁷

Oil Exposure: We currently have two oil-related positions in our portfolio and believe the oil opportunity set is ripe. As one might expect, both positions (Africa Oil: AOI and Equinor: EQNR) performed well during the second quarter, given the steady march higher that oil has made in recent months. We maintain a positive outlook for both companies, although, importantly, our posture is not predicated on an expectation for continued oil price appreciation. This is not because of our inability to imagine scenarios where that does occur, but more out of an abundance of caution for what is a highly volatile commodity that at current price levels should be more than sufficient to generate ample free cash flow for any investable oil firm.

In the future, we expect both firms in the portfolio to generate significant free cash flow and expect EQNR to reinvest that free cash flow into a combination of offshore oil and wind opportunities with high rates of return. The path forward for AOI is more complicated and does warrant a few comments.

As it currently stands, AOI holds a significant interest in several producing oil fields in Nigeria, all offshore. The working interest in these fields produced dividends worth roughly \$200 million last year, a sum equivalent to approximately 33% of the firm's current market cap. We expect this year's returns to be similar.

Management has built a portfolio of high-impact exploration opportunities via equity interests in other companies and working interests in other fields. By the end of this year (at the latest), the firm will be effectively debt-free, but they are not in control of the future of any of the many good opportunities they have in their exploration portfolio. As a result, they cannot redeploy the soon-to-be significant cash piles they have on their balance sheet absent a final investment decision by other firms. Management could pass some of that capital back to shareholders in the form of a dividend, which would undoubtedly be good for the share price, but might at any time be called upon to commit capital to a handful of potentially high return projects in their development portfolio.

This is, admittedly, a good problem for a company to have but is a challenging problem for a portfolio manager to think through. Patience and faith in management can often be rewarded, but the volatility associated with the oil industry in the last few years, combined with the antipathy much of the market has for oil and natural gas, may mean the expected return from the long right tail opportunities in the AOI equity and development portfolio fails to meet our hurdle rates for inclusion in the portfolio, driven mainly by extending timelines associated with other firms not making final investment decisions. Many investors, confronted with similar situations in the past decade, have chosen to allocate to frackers, thinking that the shorter operating cycle of the firms would allow them to better monetize oil resources by ramping up and down production. This has not proven to be the case, though, with oil prices often wrong-footing frackers, as it has this year, with many frackers reporting significant mark to market losses on oil hedges.

We continue to think the oil remains a critical component of the global energy system and will remain so for some time. We also believe it is an essential commodity for achieving a decarbonized energy system. Although counter-intuitive, the importance of a robust economy to decarbonization is so critical that if we fail to execute a staged de-oiling of our economy correctly, the resulting economic hardship will likely preclude addressing climate change altogether, let alone in the tight timeframe currently desired. Climate change might be an existential threat, but it is not an obvious existential threat to the people of large parts of the developed world, let alone the roughly 10% of the global population the lives on less than \$1.90 a day. For them, climate change concerns are a luxury they hope

an excellent economy allows them to have in the future, not a pressing concern in the present.

As always, we appreciate the trust and confidence you have shown in Massif Capital by investing with us. We hope that you and your families stay healthy over the coming months. Should you have any questions or concerns, please do not hesitate to reach out.

Best Regards,



Will Thomson



Chip Russell

ENDNOTES

1. Attribution of the core portfolio, gross of fees. Results in individual managed accounts will vary.
2. The standard deviation of daily returns in the core portfolio fell by 29.2% from Q1 to Q2 2021.
3. Another method discussed in the most recent letter to investors (Q1 2021), is to utilize call options (if available) at strike prices we have pre-determined are levels where the position will be trimmed. Thus, earning a premium (or lowering our average cost) for a contract that would execute a pre-determined trade at certain price points.
4. Weighted average based on the percent exposure an individual security has to the total gross long exposure of the core Massif Capital portfolio.
5. This could be in the form of a pre-production mining firm developing a resource, the sale of an asset etc.
6. During the life of a position, it is essential to take a page from the US Air Force and continuously employ the OODA Loop made famous by John Boyd. We failed to Observe the situation, Orient ourselves and our thesis to account for our observations, make a Decision, and Act.
7. An examination of criticality depends on the level of geographic resolution in the analysis. As a product, across many geographies, the economic criticality of gold is likely quite low, i.e. criticality of the industry to the global economy. At a local level though, a gold mining business that invests in local community providing, at times, critical infrastructure, and income streams, most certainly can be considered critical.

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