Arauca Letter H1-2023 | August 2023

Dear Investors,

I hope this letter finds you and your family in good spirits. Here at Arauca, we find ourselves particularly elated with the expansion of our team, marked by the joyful addition of our daughter Graciela on the 25th of March. Laura and I are overjoyed by this new chapter. In line with this heartwarming news, I am pleased to share that Arauca Capital has achieved a (gross) return of **+15.87% during H1-2023** (from January 1st to June 30th). It's important to note that net returns may vary based on the timing of capital entry into the fund. For specific details, please check your individual statements, which were sent directly by our administrator in early July.

House Keeping

Becoming a father for the first time has made me realize how much I owe to my growing family. My daughter Graciela and my wife Laura are not only my pillars in life, but also the biggest investors. Their future depends on how well I invest our money, my responsibility is enormous. I also want to thank the partners who have joined us in this quest. Your trust is invaluable!

Arauca is growing not only with the arrival of Graciela, but also with the help of Ricardo Gonzalez from my country Colombia. He has been involved with Arauca for a few months already, and I am very grateful to him for his constant and loyal support. Ricardo's involvement has been multi-faceted. For instance, with his help, Arauca finally produced the first presentation deck, which I attach in case you have not seen it. Ricardo has been helping us with activities ranging from the core of the fund (research and due diligence) to aspects such as regulatory matters and improving the awareness of the fund. We hope Ricardo stays with us for a long time.

Part 1 - General Update

Risk mitigation should increase over time the value of the portfolio – Option tutorial: Risk Reversals

If you recall, I entered 2023 with the largest position in safe assets (the safest part of the barbell), mostly in short term treasury and corporate bonds. Notably, this allocation exceeded 40% of the total assets under management. It's important to clarify that this stance wasn't indicative of a pessimistic/ bearish market outlook; rather, it stemmed from my assessment that the likelihood of a substantial geopolitical escalation was at its highest since I manage money (10 years). At the same time, I had to ensure the

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fund remained invested with the full allocation in our core/high conviction holdings and ready to invest in new opportunities.

Despite the large allocation to safe assets, the fund performed as well as the S&P and much better than all small cap indices, which are more comparable to Arauca given our high exposure to small companies. The high proportion in safe assets was my way of mitigating risk, and here I am going to explain something that is not understood in the financial industry. As Mark Spitznagel and Nassim Taleb have explained: "Risk mitigation needs to be cost effective e.g. (it should raise your wealth)". Risk mitigation should be additive to our fund value over time.

Before I go into more detail, let me tell you that some of our main holdings and largest positions at the beginning of the period (GIG, JDC and IDT) had flat or slightly negative returns during the period. When you add that fact to the 40% plus position on short term bonds we held, how can you explain the positive performance we had? **Well, because true RISK MITIGATION, as Spitznagel said "does not only slash risk, it actually lets you simultaneously take more risk!"**

And how did that translate into our results? First, I never sold any position that I had full conviction in. The large portion in safe assets enabled me to act quickly when I found new opportunities. More importantly, the risk mitigation allowed me to take an aggressive stance in truly amazing new opportunities, if I found them. And yes, I did find them.

At the risk of sounding too technical, I will explain the main source of our returns and how it all fits together. Earlier in the year, I discovered a company called Super Micro Computers (I will explain the company later, for now it does not matter). Super Micro was trading around $85.00 USD per share. I saw a huge margin of safety in the stock price and wanted to invest aggressively without adding too much risk. So, I entered into a bullish risk reversal, that is a strategy using options.

A bullish risk reversal involves the buying of out-of-the-money call options and simultaneously selling out-of-the-money put options. We bought a number of call options expiring in August 2023 with a strike of $100.00 USD and simultaneously sold the same number of options but now put options at the same expiry with a strike of $65.00 USD. This means that if the stock ends below $65.00 USD at expiry, I will have to use some of our cash and buy the stock at $65.00 USD. If that was the case, we would have had to deploy around 5% of NAV in the position at a much more attractive price than the $85.00 USD spot price. And remember we had 40% plus in "cash", so effectively this put option is a covered put. But now what if the stock ends up above $100.00 USD, our position will be 54% higher in dollar terms (same number of options multiplied by 100 instead of 65). The strategy costed us nothing, it was a zero-cost risk reversal. Within a few months the stock reached levels above $100.00 USD and we reduced 40% of the calls we bought (I never covered the puts). In options, once a big move occurs, I have to monetize a portion of the position, as a comeback in price can wipe out the entire profits. We continued with 60% of the initial position remaining which will be exercised as the stock trades north of $250.00 USD at the time of writing. Without a large position in safe assets, my mind probably would have been influenced by the perpetual worries and could have missed this chance. This is the purpose of risk mitigation, that I can sleep at night and ensure I am ready to add risk when it makes sense.

I am very optimistic about our fund, as we have a balanced portfolio of both hidden gems and high performers. Our new investments, one large position to be fully disclosed soon and Super Micro, are either undiscovered by the market, delivering exceptional results or both. Our core holdings, such as

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JDC, IDT and GIG, are significantly undervalued. If they continue to execute well, the market will eventually recognize their true worth and XPEL continues executing. Moreover, I want to emphasize how our risk mitigation strategy works: it does not lower our returns over time if the worst-case scenario does not happen, but rather increases them because we can take advantage of market fluctuations in a rational way over time. I understand that most people in the financial industry who do not have skin in the game (the majority) may not appreciate the concept of barbelling and risk mitigation as I explained above, and they may view any portion invested in cash/ short-term bonds as a drag on returns. However, they fail to realize that the more margin of safety one's portfolio has, the easier it is to act decisively and the better one sleeps at night, which translates in better decisions and of course if something catastrophic occurs in the world, we will have the safe part completely protected. It is a hedge against one's own volatility of judgment and against true black swans. There is a reason why Buffett keeps a large pile of cash: it may not seem rational until it does, and as long as you do understand this, my dear partner, I am satisfied. As a final note, I highly recommend reading the book Safe Haven by Mark Spitznagel for a fantastic insight on this topic.

To conclude, I maintain a large position in USD short-term treasuries. I do expect the safe part of the barbell to be around 20% of assets eventually.

Part 2 - Portfolio Update

<u>Exits:</u> We had some activity during the period. We sold our positions in META (Facebook) and Well Health after they had a massive run. I had added to META at $96.00 USD last year and sold the entire position at roughly $210. 00 USD. Yes, I missed the next leg up to $320.00 USD, as I did not anticipate $META to benefit as much as it did from AI and from the new perception from the market. META is now above my estimate of fair value, but it could end up being cheap if it continues to capitalize on AI and its new initiatives such as Threads.

Regarding Well Health, the stock had a 100% YTD performance at some point and given the risks I highlighted in my previous letter, I decided to exit completely. I still admire the CEO, Hamed, and I believe he will eventually succeed. However, when I compare the opportunities today in our other holdings, they seem much more appealing given the risk-reward setup. Our other holdings have been disciplined with capital allocation decisions, treated their shares like gold, and have small debt or net cash positions. Well Health has failed to do that in my eyes. It is hard for me to justify keeping the position in Well Health. I am satisfied with the price we exited at. It was a multi-bagger since our purchases in 2019.

<u>TPL back in the portfolio:</u> *"TPL has large random price movements, which means that with time and patience, I believe we will be able to be shareholders again. I love the asset, but I need to keep the discipline."*

I wrote the above in my last letter, but I did not expect TPL to have a 50% plus correction so quickly. Well, it happened, and we re-entered the position at $1,465.00 USD after selling last year above $2,600.00 USD and we own a few more shares than the previous time.

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The position now is deeply in the money as we received positive news about a major improvement of the long-standing corporate governance issue. TPL announced a board refreshment, with the welcoming news that David Barry and John Norris will retire from the board. In addition, Horizon Kinetics and Softvest (largest TPL shareholders) and to whom all other shareholders must be deeply grateful as they have fought diligently against the mentioned persons and management for their many detrimental proposals, have finally reached an agreement with TPL. First the board will have three new independent directors, two of whom are nominated by Horizon Kinetics, the super smart Murray Stahl being one of them. The agreement also includes that post the annual meeting, Horizon Kinetics and Softvest will be able to vote as they wish. This is very important news, and the Delaware ruling should soon bring an end to this saga of management trying to block the largest shareholders from doing the right thing. The lawsuit against HK and SV should be dropped as soon as possible and then the remaining board members should be replaced to finally turn the page. Proposal 4, which management wanted desperately to pass and essentially hoped to authorize the company to issue a large number of shares, with the risk of diluting shareholders and ending up in nonsensical acquisitions, has virtually no chance of passing now. This is all very good news. The company also started to repurchase shares in size and at attractive prices, and as of Q2-2023 still had north of $600 million USD of cash in the balance sheet.

Regarding business performance, TPL recent Q2-2023 report showed the convexity of this business. The water business generated almost $ 60.0 Million USD in revenue while spending only $ 2.0 Million USD in CAPEX (is not that impressive?). Q2-2023 had the best quarterly revenue and free cash flow of the water business ever. In fact, we learnt that 60% of the water sales were done in lands outside TPL's acreage. Can you imagine what this business alone can do? Add the oil and gas royalties and the other easement business lines and it is hard not to see TPL continuing delivering value for decades to come. I am delighted to rejoin the TPL shareholder community, after a brief hiatus of a few months. However, I will remain disciplined and prudent in my investment decisions, and if TPL becomes excessively overvalued again, I will act accordingly as I did in 2022.

Special Situations: I had three profitable investments in special situations and one where we lost money. Overall, the strategy was successful and yielded some profits for the fund. We made money with Jounce Therapeutics, Mei Pharma and Quince Therapeutics and lost money with Atea Pharmaceuticals.

The strategy involved identifying biotech companies that were trading at a significant discount to their cash value, with the goal of realizing some of the value that was not currently reflected in the market price. This was achieved by targeting companies with shareholders who had a track record of exploiting this opportunity, such as Tang Capital, which is known to offer to buy the entire company at a price above the current market value but still below the cash value. I bought the stock once Tang announced large acquisitions of the stock or a full buyout offer, as long as the current price was still below the offered price. All positions were exited rather quickly. These opportunities are rare, maybe I will find more.

Super Micro Computers, INC (SMCI): SMCI was our top contributor to returns in the period. Previously, I explained how I structured the position and, as of the time of writing, I want to share that I have entered into a bearish risk reversal, essentially locking the price at $250.00 USD. Specifically, I bought puts with a strike of $250.00 USD and sold calls with a strike of $305.00 USD. The move in the stock has

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been parabolic and I want to protect the profits given a very possible correction. Remember that our original calls expired at $100.00 USD.

Super Micro produces motherboards and servers, specifically designing, developing, and producing accelerated platforms for high-performance servers and storage systems. The company is a direct beneficiary of AI, 5G, cloud computing, data centres and edge computing. If you wonder where the majority of all the CAPEX ends up that the tech giants are spending to ramp up their AI new products? It is mostly spent on servers, and on servers that can adjust quickly to new innovations in semiconductors. Super Micro is exactly at the core of this trend.

The computing industry is undergoing a major shift towards accelerated computing and generative AI, with companies like NVIDIA being the most visible leaders in this transition. Super Micro CEO/Founder Charles Lang founded the company the same year NVIDIA was founded. The two founders have been partners for a long time. Super Micro has been able to adopt new technology faster than the competition, in some cases up to 18 months faster. Super Micro is able to maintain such a moat in speed due to its unique design capabilities and flexible manufacturing. Whenever NVIDIA launches a new GPU (graphic processing unit), Super Micro is most likely the first server company to have them in its products.

When I discovered Super Micro earlier this year, the company was trading at less than 7 times P/E. This type of valuation for a company at the core of possibly the biggest shift since the invention of the internet, which controlled 7% of the world market share and has been rapidly expanding it, was an incredible opportunity. I had to act fast.

The company has been executing superbly, growing revenues with record backlogs and launching new products. The only problem we have faced is that the stock price moved too much too fast. Within a few months, the stock reached levels above $300.00 USD. Given that the original position is in derivatives, a major pullback could substantially reduce our profits. I decided to protect them with put options (funded by calls) as mentioned above.

Opera: During the period, we were long Opera and fully exited our position. Opera is a company that develops web browsers and other software products. When I discovered Opera, the company was trading at less than 5 times earnings with a large margin of safety based on its cash balances and holdings in other companies. Initially, I had some doubts about investing in Opera, given that the controlling shareholder is a Chinese company that owns most of the shares, leaving minority shareholders with no voice in the company.

However, due to the low valuation, large margin of safety, and Opera being a beneficiary of the AI trend, I decided to start a position as the company was also buying back a large amount of stock. This was the catalyst for me to give the benefit of doubt to the majority shareholder and take that risk.

The stock had a large move, and we made around 3% returns in total for the fund when I exited the position. It was a big contributor to our returns. However, I decided to sell as the controlling shareholder announced that they were looking to issue some shares and potentially sell a big chunk of the stock they held. This, in combination with some promotional press releases which made no sense to me, made me decide to exit. They also offered a large buyback simultaneously, which seemed

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contradictory. The stock was trading at its highs, and we managed to exit right after the press release came out. We are not planning on coming back to this stock. It was a profitable investment.

Gaming Innovation Group (GIG): GIG remains our largest holding, and as mentioned before, despite extraordinary execution, the stock was down roughly 10% during the first half of 2023. This discrepancy between value and price has allowed us to add to the position opportunistically.

To understand the discrepancy, as I explained in my previous letter, GIG paid essentially two times EBITDA multiple for Ask Gamblers. These assets under Catena had declining revenues. With Q2-2023 earnings, the market learned that under GIG, Ask Gamblers delivered a +45% increase in revenues and doubled EBITDA. This happened only in a few months since the acquisition. However, the integration is not fully complete yet, meaning results should get better over time. This to me was mind-blowing. Think what GIG can do when presented with similar opportunities. GIG overall continues growing around 40% (22% organically) as of Q2-2023. Most notably, EBITDA margins reached 45%, which is close to the target of 50%. Execution is impressive.

In addition, the platform business is having roughly 35% EBITDA margins and healthy growth. Remember, this division was generating margins of 11% in 2022. Overall, GIG is improving in all segments. What struck me more about the platform business was the announcement of Richard Carter as CEO of the platform company once spun off. Richard is widely regarded and is one of the most influential figures in the industry. Richard was the co-founder and CEO of SBTech, which eventually was sold to DraftKings in 2020. He is a key leader and a notable sign of what he sees in the business.

As of the time of writing, management gave guidance of €125 – 130 million EUR in revenues with EBITDA margin between 47%-50% for 2023. That brings us to roughly €60 million EUR on EBITDA for 2023. The current EV of the company is approximately €380 million EUR, meaning the company is trading at 6 times EV/EBITDA or less than 5 times with 2024 numbers. This multiple for a company that is going to unlock value by the division of the media and platform-sportsbook business into two companies, with expanding margins, geographies, and high levels of growth, is extremely low. I am very excited to see what GIG can keep doing.

JDC Group: JDC was another company with relatively flat stock price performance while the fundamental business execution on my investment hypothesis has played out very well. Recently, JDC has suffered in the advisory segment due to inflation and the war in Ukraine, which has deteriorated market sentiment and temporarily reduced the assets under management, resulting in reduced income fees. However, I remind you that the core of our investment hypothesis is the Advisortech segment, which, as explained in my previous letter, needs a little bit of time to show results. This segment was temporarily affected by the fact that the large contract with VKB took longer than expected to be signed. In my mind, this was never a risk as VKB is a large shareholder of JDC.

At the time of writing, these headwinds have passed. On August 16th, the market learned that the VKB contract was finally signed, and the advisory segment is recovering substantially as per management.

But what excites me most is the progress in Advisortech. A few highlights: First, the results in Q2-2023 started to meaningfully inflect with an increase of 17% in revenues and a 37% increase in EBITDA. The

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annual net premiums reached the €1 billion EUR mark. The JV (Summitas) started with its first acquisition by purchasing MVM Münchener Versicherungsmakler. Management expects Summitas to deploy between 70 to 100 million EURO in the short term for further acquisitions. JDC signed a 5-year contract with R+V, ensuring full entry into the cooperative banks. This deal, which management has not made a lot of noise about, can become a major source of revenue for JDC (into the 100s of millions) if/when the cooperative banks are onboarded.

JDC brought Marcus Rex from Hypoport. Marcus was the head of insurance at Hypoport. This hiring is a major signal to the market that a) Hypoport is probably exiting or substantially reducing its insurance operations and b) JDC is not only expanding its moat by pleasing clients, signing new contracts, expanding verticals but also bringing top-class executives from major competition and most importantly making the competition retreat from the insurance business.

Finally, JDC continues to onboard saving banks within the Provinzial network at a fast pace, started to roll out the pluginsurance segment within eVorsorge and has extended major contracts with Finanzguru and Albatros.

It is clearly visible that JDC has made a lot of progress while the advisory segment has temporarily eclipsed it.

Final comments:

We currently are long an undisclosed name that designs and distributes IoT products. As the stock is illiquid, and I am getting more excited the more I discover the company, I decided to fully disclose it somewhere in the future. Ricardo is helping strongly with this name, and we will be glad to share our findings with you in due course, though if you follow me closely, you will be able to find out the name.

I trimmed XPEL, as the level of valuation compared to the size was not making me comfortable; however, this can be a mistake as XPEL continues delivering extraordinary results and indeed deserves a premium valuation. XPEL new verticals continue to drive fast growth to the company and particularly arquitectural window film is starting to become meaningful. In addition, the OEM partnerships can be a game changer for the company, XPEL just started to deliver results with Rivian. Imagine what further partnerships can do.

Part 3 – Final Thoughts

"Everybody thinks being a great investor is only about finding great companies at good prices. Great investors are quick at selling when facts change. Selling on time when you realise you hold wrong investments has an enormous compounding effect. It is just less visible."

Here is a quote that I posted on Twitter about the art of selling. Selling well means getting out of a position when the facts change. For example, we sold OPERA at the top when they announced a share offering, and the stock lost 55% of its value afterwards. We also sold Verde Agritech when I discovered that the CEO was using Twitter ads to hype up the company while selling shares himself,

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and the stock crashed 70% eventually. The same story repeated with Coinshares, IPA, GAN, and others over time. These companies are not likely to regain their value, as the facts exposed a different reality than what I had assumed about them, and time confirmed their business deterioration. At Arauca, we not only find good businesses, but also let our positions go when the facts change or when I realised that I have made a mistake. What is most remarkable, in most of the mentioned examples, we made money while having a wrong hypothesis of the company, just acting quickly ensured that positive return. Compounding is wonderful with positive returns but devastating with negative returns. That's why selling on time is an essential skill, but often neglected.

I want to end this note by thanking my wife Laura for her constant support, my daughter Graciela for her inspiration, Ricardo for his effort and loyalty, and my investors for their trust.

Sincerely,

Jean Philippe Tissot

Jean Philippe Tissot full track record

	Year	Gross Returns
Partnership	2014	*12.47%*
Partnership	2015	*-8.32%*
Partnership	2016	*63.42%*
Partnership	2017	*12.62%*
Partnership	2018	*0.81%*
Partnership	2019	*43.14%*
Partnership	2020	*84.21%*
Partnership	*2021 H1	*16.11%*
Arauca Capital	**2021 H2	*-11.42%*
Arauca Capital	**2022 H1	*-24.85%*
Arauca Capital	**2022 H2	*+7.06%*
Arauca Capital	**2023 H1	*+15.87%*
	CAGR	***16.96%***

** Arauca Capital was launched in July 2021*
*** Gross returns do not include management fee*

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