MASSIFCAPITAL

May 3, 2024

Dear Investors,

Through the end of the first quarter of 2024, the Massif Capital Real Assets Strategy was up 0.96% net of fees, with gains from both the long and short books. As the letter is getting out after the close of April, it is worth highlighting that we were up 2.26% in April, with gains on both the long (up 1.93% gross of fees) and short (up 0.42% gross of fees) sides of the book, bringing our returns through the end of April to 3.14% net of fees.

Our largest positive returns in the first quarter came from our position in Siemens Energy, up 43%, followed by our long-standing gold position in Equinox, up 28%. Our closed-out position in Piedmont Lithium and the Global X Lithium ETF remain the most significant short-side contributors for the quarter. Dragging on results during the first quarter was our position Enovix, which was down 34%, followed by AES, which we exited earlier in the year.

| Portfolio Contribution (Gross of Fees)* | January | February | March | 1st Qtr | April | YTD (5/2/24) |
|---|---|---|---|---|---|---|
| Long | (5.18%) | (2.19%) | 8.78% | 0.91% | 1.93% | 6.42% |
| Short | 1.43% | (0.78%) | (0.48%) | 0.23% | 0.42% | 0.24% |
| **Total Return** | **(3.75%)** | **(2.97%)** | **8.30%** | **1.14%** | **2.35%** | **6.66%** |
| *Total Return (Net of Fees)* | *(3.80%)* | *(3.02%)* | *8.11%* | *0.96%* | *2.26%* | *6.34%* |
| Gross | 135.13% | 98.83% | 100.96% | 100.96% | 110.11% | 100.96% |
| Net | 44.36% | 74.92% | 98.81% | 98.81% | 89.22% | 98.88% |
| **Equity and Options Book (Gross of Fees)*** | | | | | | |
| Energy | (0.76%) | (0.78%) | 1.51% | (0.10%) | 0.30% | 0.51% |
| Industrials | 0.59% | (1.01%) | 1.00% | 0.55% | 0.66% | 4.24% |
| Materials | (2.43%) | 0.24% | 5.57% | 3.01% | 1.70% | 4.29% |
| Utilities | (0.81%) | (0.93%) | 0.44% | (1.30%) | (0.49%) | (1.53%) |
| Other | (0.36%) | (0.48%) | (0.22%) | (1.02%) | 0.19% | (0.86%) |
| **Additional Return Data (Gross of Fees)** | | | | | | |
| Tail Risk Hedge - TRH - (Only Calculated on a YTD Basis)^ | | | | | | (0.13%) |
| Options Trading Return, Inclusive of TRH* | 0.31% | (0.24%) | 0.06% | 0.13% | 0.13% | 0.28% |
| Isolated Return on Dividends Paid* | 0.03% | 0.59% | 0.04% | 0.61% | 0.18% | 0.79% |
| T-Bill* | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |

*Data: NAV, Inclusive of Dividends Paid

^Data: Rolling Estimate based on Massif Calculations

From a factor perspective, we had positive returns from both our portfolio's factor exposure and alpha. Through the end of the quarter, Omega Point estimates that 84.6% of our returns were attributable to alpha and 15.4% to factor exposure. Within our different factor exposure buckets, we benefited most from Global Market Exposure and Value factors, while Size, Canadian country exposure, and Metals and Mining Industry exposure produced the most significant factor drag.

From a stock-picking perspective, although absolute returns were benign, we are happy with how the portfolio performed. We are pleased that while we had a negative factor drag from Metals and Mining exposure, it was our best-performing sector, meaning we bucked the industry trend during the first quarter because of our specific stock picks.

The fund's gold exposure (up 22.8% in Q1) outperformed the gold price (up 8.3% in Q1), the GDX (up 1.9%), and the GDXJ (2.1%). Our copper investments (up 19.5% in Q1) outperformed copper (up 2.3%) and copper equities (as measured by the Global X Copper Miners ETF, up 13.1%). Even in the case of aggregate exposures that returned a negative result, such as our Lithium exposure (down 11.9% in Q1), we kept up with the industry (as measured by the Global X Lithium ETF, down 11.0%). The Metals and Mining industry factor had a cumulative Q1 return of -3.1%. During April, the Mining industry factor reversed itself, generating a 7.7% return. We did not keep up with that but did generate a 2.9% return from our mining investments.

The Massif Capital Small Cap Universe was down 9.5% in the first quarter, the segment of the universe of stocks we pick from that most closely resembles our portfolio. We did not keep up with the Massif Capital Large Cap Universe, which was up 3.5%. The underperformance of the large-cap universe is disappointing. Still, we are early in the year and believe we will continue outperforming the large-cap universe on a rolling three and five-year basis. The S&P Real Assets Equity Total Return Index, the best widely available benchmark for our portfolio (despite our 0.3 correlation), was down 0.08% in the first quarter and 2.5% through the end of April.

The remainder of this letter covers two topics: a review of interesting trends in the gold market and an overview of our position in OCI, which we have yet to discuss publicly. This letter is shorter than usual due to a high volume of new idea research in both March and April, which we expect to discuss in more depth in our investor-only monthly letters.

## An Interesting Situation in Gold – Bucking the Trends of Recent Economic History

A traditional fair value model of gold would connect real rates, economic growth expectations, and the dollar to flows and the price. This approach assesses the fair value of gold by taking the opportunity cost of holding gold vs. other financial assets as the core variable in determining a price outcome. Yet none of those traditional factors adequately explain the scale of the recent gold price moves (up 8.3% in the first quarter and a further roughly 1.5% in April).

We would argue that this is a function of a shift in consumption patterns from a long-term wealth-driven consumption pattern to a fear-driven pattern. Inverse correlations, like the relationship between the USD and Gold Price or interest rates and Gold Price, are not physical laws; they are mathematical representations of human decision-making processes. Decision-making processes are dynamic, malleable, and context-dependent, often shaped by what would ordinarily be considered irrelevant factors and people’s mental representations of the world.

This reality is important to recognize because the historical economic models sometimes stop working due to human nature. When one is happy, healthy, and focused on wealth accumulation, not only is one's financial risk tolerance higher, but the outcome one is looking for is not a slowly appreciating store of value but rather a meaningful upside, hence pricing gold within the context of other critical drivers of financial asset returns. Within the context of the market pricing in progressively fewer Fed cuts, a rocketing USD, mixed economic growth trends, and record equity markets, gold has rallied 25% since the

October 2023 low of $1820. This makes little sense. The numbers are correct; the model is wrong. The decision-making process has changed.

Most of the gold upside since mid-2022 has been driven by new incremental (physical) factors, the most significant of which is an acceleration in central bank buying, Asian retail buying, and US retail buying.[1] Current macro policy and geopolitics affirm those factors well if we assume fear is the core variable in buyers' decision-making.

- According to the World Gold Council 2023 Central Bank Gold Reserve Survey, central banks' accelerated gold accumulation has been catalyzed by general unease with being overly levered to the USD-denominated financial system, inflation concerns, and geopolitical instability. This is not a short-term trend; it is just a trend that has accelerated in the last two years. Central Banks flipped from net sellers of gold to net buyers in 2009, having been net sellers since 1975.
- Asian retail demand, led by China, has been driven by fear over economic stability and currency depreciation, particularly tied in China to the property sector.
- US fiscal sustainability concerns, combined with incremental risks from the election cycle, can be seen as another feature of brewing structural fear that positively influences gold buying.

If fear is in the driver's seat for the moment, then our downside scenario analysis must look for the variables that might prompt fear to subside, resulting in opportunity cost (the wealth factor) to reassert itself as the critical decision-making paradigm. We would identify the following events as likely to reduce fear and thus slow gold price momentum:

- Peaceful resolution to the ongoing Middle East and Ukraine conflicts and settling in associated sanctions and geopolitical risks. We put the probability of this event as negligible.
- Sufficient Central Bank buying such that the gold share of Central Bank assets reaches portfolio concentration levels that raise concerns. We cannot put a probability on this scenario due to information availability of Central Bank preferences and constraints in portfolio construction, but according to the World Gold Council, 15% is an often-cited level of gold ownership that Central Banks target. We do not know when this level will be reached or if the historical level is still relevant.
- A rebound in Chinese growth. This is a certainty at some point, but the timeline is highly uncertain.
- A peaceful election cycle in the US combined with a retreat to the center by both political parties. This also has a negligible probability.
- A new Fed/Central Bank rate hiking cycle. It is difficult to say, but certainly more likely than peace in the Middle East or de-escalation in the extremity of US political parties, but it does not seem particularly likely this year.

The near-term potential for these events or a combination seems exceptionally low, underpinning our expectation for continued bullish momentum in the gold price. As such, we expect to see continued good results this year from our core gold positions, which comprise roughly 14% of the portfolio at the current time.

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[1] Most readers will know Costco has now started selling physical gold; what might surprise some is the estimate of the volume of gold being bought by US consumers at Costco. According to recent reporting by the Economist, while retail punters are dropping paper gold held via ETFs, they are gobbling up the physical stuff. It is estimated that Costco is selling between 40,000 and 80,000 ounces of gold a month, or between 25% and 50% of the volume of gold the Chinese Central Bank has been buying.

Our exposure will be naturally reduced this year by 4% via Chinese firm Yintai Gold's takeout of Osino Resources, a Namibian-focused gold miner we invested in late last year. When the deal closes, we will book a 33% position-level return and a 1% portfolio-level return in a short 165 days. Osino will be the second junior gold miner we have invested in since 2019 that has been taken out by a Chinese gold miner. Osinio is also the third round-trip gold investment we have made since 2019. We have made money from all our closed-out gold mining investments. Our remaining gold positions in EQX and an undisclosed junior are both in the black.

Before shifting away from our gold discussion to OCI, we would toss out one further intriguing idea: to the degree that gold and US treasury rates rise simultaneously, investors are showing a preference for real assets. If we assume the ultimate safe financial asset is the US Treasury, buying it suggests confidence in the international monetary system that it underpins. On the other hand, if Treasury yields rise while gold prices rise, it indicates a desire for safety from investors while also expressing a concern for the stability of the system underpinning the traditional “risk-free” asset.

## The Evolving Situation at OCI

One position in the portfolio we have not discussed much in our earlier letters to investors is our 6% investment in OCI, which we started in April 2023. Despite important catalysts, the stock is currently trading at our entry price. On a total return basis, we are up 16.1% in the position due to regular and special dividends paid out last year. We expect to receive another significant special dividend this year, as outlined below.
For those unfamiliar with the company, OCI is a European-listed, global fertilizer business focused on the “3 F’s” of fuel, food, and feedstock. This company is essential to food supply chains and owns a strategically valuable, global asset base that would be difficult to replicate. The firm is the world's largest exporter of nitrogen fertilizer products and the only major producer with international production, distribution, and storage capacity in the US, Europe, and the MENA regions. The firm is a “family business,” now helmed by the second generation of the Egyptian Sawiris family.

Our initial interest in the business started in 2022. At the time, we were reviewing the fertilizer industry for potentially interesting short opportunities, as fertilizer prices were trading at what we judged to be cyclical peaks. While we did not find any short opportunities we liked, our sum-of-parts analysis suggested that OCI could be worth €50 per share vs. its 2022 peak of ~€43 per share with a downside of €20 per share. We judged the valuation discount insufficient to justify an investment at the time but enough to put it on a watch list.

By March/April 2023, the stock had fallen by roughly 50% relative to its 2022 high due to a nearly 80% collapse in Middle Eastern ammonia prices (the core nitrogen fertilizer medium relevant to OCI). With that price fall, we accumulated a 6% position. We were rewarded in December of last year with the announcement from OCI that it was making two significant asset sales as part of a strategic review prompted by activist investor Jeff Ubben’s 2022 prodding:

- The first announcement was the firm's $3.6 billion sale of its controlling interest in Fertiglobal PLC, the Abu Dhabi-based fertilizer venture with the Abu Dhabi National Oil Company (ADNOC).
- The second announcement was the sale of the firm's 100%-owned Iowa Fertilizer Company, OCI’s US nitrogen fertilizer business, to Koch Ag and Energy Solutions for $3.6 billion.

In December of last year, the firm announced asset sales, net of debt, of $6.2 billion, or roughly the firm's market capitalization at the end of 2023. The firm has traded down in 2024 and is currently sitting at a discount of ~6% to the cash we expect the business to receive at some point this year for the assets it has sold. Management has noted that they expect to return "a substantial amount of capital to shareholders…in a very tax efficient manner."

Why the stock is now trading below the cash value of the two deals, especially given the remaining assets the firm owns and management's good track record of creating value, is a mystery. If management had a history of destroying shareholder value, we could understand; after all, many management teams have bungled the capital allocation job when confronted with a large pile of cash, but this is not the case with OCI.

Furthermore, the business has other assets, specifically its European Nitrogen business, Methanol operations, and a currently under-construction ammonia plant in Texas, expected to be up and running in 2025. Finally, as Management noted in the FY2023 call in February, they intend a 2024 capital return of about ~€12 per share.
Management also outlined on the same call that, in addition to the $3 billion capital return, they intend to use proceeds from the asset sales to pay down debt (~$2 billion) and fully finance the remaining CapEx on the firm Texas facility (~$500 million). This leaves the firm with a net cash position of $700 million at the end of 2024 if everything runs smoothly. According to management, the firm's post-transaction assets generate roughly $500 million in mid-cycle EBITDA, and the Texas ammonia facility is expected to generate mid-cycle EBITDA of $100 to $200 million.

Assuming the business trades at a 5-year historical EV/EBITDA of 6x and generates $600 million in EBITDA in 2026, the post-transaction equity stub is worth roughly €18 per share. Put another way, assuming a hard cash return of €12 in 2024, the market is pricing the ongoing business at ~€13 per share, a 38% discount to our estimate of the value of the remaining assets.

Although we do not believe there is strong evidence to support the idea that public markets will value the equity stub at the current 8x EV/EBITDA multiple the firm is trading for, management did sell the Iowa operations to Koch Industries at an 8x EV/EBITDA multiple. Assuming an 8x multiple, the post-transaction business is worth €23 per share. At a 3x multiple, the five-year low, the post-transaction business is worth €11 per share, implying a ~8% downside from the current share price after netting out the expected ~€12 per share capital return.

Although this investment has become complicated, and we are unconvinced a breakup was the route to the highest investor returns, we are satisfied with how this investment is unfolding. If the firm price falls by €12 on the day of the abnormally large capital return, we will have a mark-to-market loss on the core equity position of 48%. However, we will also have received 65% of our original investment back in cash. If the remaining equity position rerates to between €18 and €23, we will still have a mark-to-market loss but a total return inclusive of dividends/capital returns of between 37% and 57%—a potentially tidy little investment and an interesting tax situation for us to consider.

One final observation: the EV/EBITDA difference between where publicly traded fertilizer companies trade and the multiple at which OCI management sold the firm's Iowa business is intriguing. The discount is part of a trend we have seen in which public equity markets do not adequately value difficult-to-replace industrial assets. We attribute this to a focus on cash flows in private markets for real assets vs. the growth focus of equity markets. This is a strong opinion, loosely held.

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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,

William M. Thomson

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