



## Manager's Message:

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Dear investors,

In its more than 100 years of history, the Luxor Group has undergone several periods of transformation. Throughout this journey, our capacity to evolve without losing our essence was vital to achieve this rare longevity.

We have learned that excellence depends on a constant process of improvement. Therefore, we seek constant evolution of our practices, without losing touch with the most fundamental elements of our identity: our investment philosophy and our principles. Thus, the biennium 2021-22 brought important news, which we will share with you.

Throughout the first half of this year, we have redefined the structure of our funds, with two main goals: to make the operation more efficient; and to allow employees and partners to invest more easily.

In addition, we have adopted a new communication process, one that is more structured and regular with our investors, composed of: (1) this semi-annual letter, in which we are going to talk about the implementation of our strategy, in March and September; and (2) the direct interaction with us, as desired.

Thus, we are formally inviting you to reach out to us, whether to discuss investments, to ask questions about the fund's management and our main positions, or so that we can contribute in any way on issues regarding investments and finances.

Finally, we renamed our fund to enhance the connection between its name and our group's identity. Since September, the fund has been called **Luxor Mangalarga** – a reference to our founders' passion for horses and to our view that our investments must have their courage and resilience.

All our energy and efforts are focused on building the best portfolio possible – and we are confident that this will be reflected in excellent returns. Our purpose is to offer you the best investment vehicle we can build.

In this first letter, we are going to focus on three main themes: our investment philosophy; how we apply this philosophy in an effective portfolio's management (for this, we will use the turbulent year 2022 as a practical example); and finally, we will explain our view of the current moment. We will be brief and leave the details and/or deeper discussions for those who are interested in direct conversations.

Best regards,  
**Grupo Luxor.**



# Investment philosophy

Having an investment philosophy is key to managing portfolios. The volatility in the markets and economies is an element of great complexity for those who work with investments, as it brings an emotional component to the investment process. Thus, having a framework that can guide decisions throughout these challenging moments is one of the main factors that differentiate good portfolio managers.

At Luxor, our decision-making process is guided by our philosophy. Its roots come from the entrepreneurial origin of the group, but it is constantly evolving. Now, we are not only business managers, but also investors allocating capital in the best possible way.

There are three principles that guide our investments. First – and most important – we believe that investing in great companies is our best way to achieve both capital preservation and high returns on capital in the long run. Anyone who has owned or run a business knows the challenges and the risks involved in any enterprise. Still, the uncertainty also creates an opportunity: companies usually reward investors with high returns on invested capital when they succeed. We are confident that the combination of a diligent analysis of each company that we invest in and its sector, with the understanding of what are the risks involved and a well-designed strategy to deal with these risks will allow us to have great returns on capital.

Secondly, we believe that we can identify businesses with great return prospects through our fundamentalist and value oriented analytical process. In summary, we look for companies with the following characteristics: (1) business led by honest and competent people; (2) exceptional business, with broad competitive advantages and great barrier to entry; (3) companies that are at the forefront of their sectors, gaining market share over time; (4) companies in sectors benefiting from secular trends in societies and economies; (5) companies that have all these characteristics at reasonable and understandable prices; and (6) solid balance sheets, with low indebtedness.

Moreover, we believe that the combination of our long-term orientation with the construction of a solid and balanced portfolio gives us an advantage to deliver good returns. By avoiding excessive losses, we have the chance to take advantage of unfavorable market environments through opportunistic investment in great assets that can eventually be priced at unreasonable discounts.

Finally, we are humble. We believe that we can apply our knowledge to pick good assets and generate good returns, but we know how hard it is. We treat the complexity of the world and markets with caution – and this translates into the extreme diligence and analytical discipline we employ in our daily work and in our prudent approach to allocating capital. Unfortunately, hard work and extreme diligence in our investment process are key, but not enough to eliminate the chance of making mistakes or being surprised at times. Still, we believe that our approach allows us to get things right more often than wrong and deliver good results.

Applying these principles in our daily work is a constant challenge since opportunistic narratives and collective "manias" will always be present. Thus, our philosophy is our compass: the fundamental instrument that guides our investment practices, keeping us on course in all circumstances.



# How do we apply our philosophy:

## 2022 as a practical example

Faced with a scenario of rising inflation and interest rates, war and risks of slowing the global economy, 2022 has been quite a challenging year. We will focus not on explaining such events, but on showing how we deal with these circumstances. First, we consider that being always alert and prepared is the best way to deal with crisis rather than trying to predict them. Moments like these offer an intense mix of risks and opportunities that require even more skills from portfolio managers. We will explain our strategy to deal with the current market environment, focusing on three major decisions and a brief analysis of a company which we decided to divest from – Netflix.

The first important portfolio decision of 2022 was made by the end of 2021, when we chose to moderately reduce our exposure to some of our companies, based on the understanding that valuations were demanding. According to our philosophy, we consider valuations to be a risk factor. Due to the high multiples, we were not able to find good enough expected returns in some cases, considering both individual companies' growth prospects and the expectations of higher interest rates, and we decided to trim some positions. However, following our commitment to invest in businesses and our limited capacity to time the markets, we kept our portfolio mostly invested in stocks.

We always invest part of our capital in assets that are not correlated to public markets to balance our portfolio and improve our performance in the long-term – both by trimming our drawdowns and allowing us to invest in businesses that are excessively penalized in times of exaggerated risk aversion. Thus, our second important decision for 2022 was to combine our investments in stocks with investments in hedge funds that we believe can perform well in any market condition. Fortunately, this strategy paid off: our performance in the year had a very positive contribution of these funds, which helped balance losses in the stocks market.

The third decision that is worth mentioning was the movement to buy shares that we made between June and July. Even though much of the economic outlook

reevaluation and companies' profitability that was incorporated into stock prices throughout the first half of the year has been justified and had an impact on earnings, the fear of an uncertain future has also generated opportunities, for what we tried to take advantage of. Some of the companies we invest in, such as Microsoft, Alphabet and Amazon have had significant pricing, even without further disappointment in their performance. Therefore, we used the profits we had in our investments in hedge funds to increase our holdings in these businesses.

Finally, we will briefly address a company from which we have decided to divest – Netflix. Following our philosophy, we invested in the company in March 2019 based on the understanding that it had characteristics of a great business: high returns on capital, recurring and predictable revenue, protected by solid competitive advantages of scale and intellectual property. Allied to these characteristics, there was a deep admiration for the history of the company and the executive team. Our long-term thesis was based on continued growth of the user base within an addressable market of 700 million homes worldwide and exercise of market power. What's changed then?

It has changed the perception of the competitive conditions of the segment in which Netflix operates and about the size of the business and its addressable market. We consider that the greatest enemy of return for any business is competition. In this case, the emergence of market alternatives such as Disney+, HBO Max and Amazon Prime has limited Netflix's ability to exercise market power and grow its user base. In addition, we reduced our estimates of the addressable market due to the difficulty of producing local content outside the United States. Therefore, based on the deterioration of the foundations of the thesis, we chose to divest. It is worth mentioning that maybe we were a bit late to react to the changes we were observing in the fundamentals of business in this case – lesson learned.



## Our latest views

Even though we followed our investment philosophy and with all our efforts to build a portfolio that maximizes our chances of success, our performance this year is disappointing. We have two comments about this. First, it is important to highlight that we invest for the long-term and as such moments like these are inevitable. We don't intend to anticipate price actions arising from macroeconomic circumstances because we do not believe that it is possible. Despite the discomfort, we believe that our portfolio will recover, and our resilience will pay off.

We emphasize that our way of dealing with these moments is to have a balanced portfolio, keeping our capital allocated in companies that will come out of this difficult period winners in their sectors. Sudden movements in the portfolio at unfavorable times can become extremely costly in the long run. Therefore, as we cannot predict the duration of this crisis, we prefer to keep our focus on the performance and the fundamentals of each company that we invest in, trusting that as soon as the macroeconomic conditions comes back to normal our portfolio will be composed of companies that will benefit the most from the improvement in the economic environment. We stand firm in this intention.

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“The world changes according to the way people see it, and if you can alter, even by a millimeter, the way people look at reality, then you can change the world.”

JAMES BALDWIN

