BPI IBERIA FUND

PERFORMANCE REVIEW

In the fourth quarter of 2022, the Fund went up 13.4% and outperformed the benchmark in 149bps. The Fund's FY22 performance was 3.36% vs -0.16% of the benchmark.

The best contribution came from stocks exposed to non-cyclical consumption with +69bps vs benchmark, in which we highlight our overweights in Vidrala and Logista. Vidrala had a very weak performance in the first 9M22 as the glass container industry is very exposed to energy costs, which rose dramatically during the year strongly impacting margins and profitability. Despite this challenging environment, the company took steps to reduce its gas dependence and also announced price increases to partially off-set that situation. In mid-October, its share price started to recover after the European Commission announced measures to limit imported gas prices. Additionally, Verallia, one of its main competitors, announced the acquisition of Allied Glass in the UK at multiples consistent with higher valuations for Vidrala. And lastly, Vidrala presented good 3Q22 results with EBITDA margin recovering at a much stronger pace than expected and the company confirming that demand remained strong. In the case of Logista, it presented consistent FY22 results but in-line with expectations. For 2023, the company guidance is to grow adj. EBIT above mid-single digit and it also stated that it will continue to look for acquisitions focused on value-added services. During the quarter, the company also benefited from being selected to join the IBEX35.

The second best contributor was the Financials sector with 44bps vs benchmark mainly due to our overweight in Sabadell vs underweight in BCP and overweight in BBVA vs underweight in Santander. The European bank's sector had a very strong quarter on the back of interest rates increases and ECB's hawkish tone. Sabadell, which is one of the more sensitive names to Euribor's evolution in terms of bottom line, presented excellent 3Q22 results with NII growth accelerating, good fees performance, cost containment and cost-of-risk under control. All this together meant a net income 40% above consensus. FL CET1 is at a comfortable level of 12.52%. BCP also presented good 3Q22 results mainly due to strong NII growth. Nevertheless, adjusted FL CET1 ratio is below peers at 11.8% (11.4% reported) which is particularly negative considering that BCP still has a gap to comply with MREL capital of 27.29% by 2024. Consequently, this translated in a recent expensive 3-year Senior Preferred debt issuance at 8.5% yield. Within globals, BBVA's results outpaced, again, Santander's earnings due to the relative outperformance of Mexico vs Brazil. In BBVA, Mexico's local currency net income grew by 45% yoy mainly boosted by NII growth of almost 30% and cost-of-risk under control. In the case of Santander, Brazil's local currency net profit drop by 2% yoy damaged by weak NII and fees performance and by cost-of-risk deterioration which was already seen last quarter.

The main detraction came from Airlines with -20bps due to our underweight in IAG. The company published a trading update ahead of 3Q22 results in which it pointed to a quarterly EBIT of €1.2bn vs €0.8bn of consensus expectations, backed by better than expected passenger revenues. On demand side, forward bookings have been running at a rate of 90% of 2019 levels in terms of volumes and 100% in terms of revenues.

During the quarter, we opened a new small position in Caixabank reducing the underweight in the stock due to the excessive fall after the 3Q22 earnings release.

FUND INFORMATION

Manager:
Pedro Maruny

Fund AUM (€):
36.4 Million

Share Class:
Class I

Minimum Investment:
EUR 250 000

Inception Date:
April 2007

Fee Structure:
Subscription Fee: 3%
Management Fee: 1%

Bloomberg Code:
BPIIBRI LX Equity

ISIN Number:
LU0292622254

Results came 13% above consensus expectations sustained by NII, fees and provisions. FL CET1 came at 12.1% slightly below expectations. This position was later closed after a good outperformance of the stock.

We increase our weight in Cellnex after the agreement between Vodafone and GIP/KKR for the latter to buy a stake in Vantage Towers at c.24x EV/EBITDAal.

We opened a small position in BCP as it was underperforming its main peers on total capital concerns with the market acknowledging the need of further expensive debt issuance. We believe that these fears were somehow justified but a little bit exaggerated in dimension.

Finally, we increased our overweight position in EDP and almost sold our position in Acciona. EDP's exposure to hydro had strongly penalized its performance during 2022 but it should start to contribute positively to company's earnings in the next quarters as rainfall levels have been normalizing in the last months, and we believe that has a better risk/reward proposition vs Acciona.

INVESTMENT CASES

Grifols

At the same time of last year, we wrote an Investment case on Grifols reviewing the reasons for having been one of the worst performers in 2021 and arguing why we believed that it was worth to have an overweight position on it. In 2022, most of the problems continued to be present and the stock had another awful year, fortunately, acknowledging the risks, BPI Alternative Fund's long position was small position throughout the year.

Grifols' financial situation was far from good at the end of last year (6.2x ND/EBITDA) but it has sharply deteriorated in 2022 reaching 9x ND/EBITDA at 1H22. This is particularly worrying considering that the company has 35% of its debt of floating rates and interest rates are going up so rapidly.

The reasons to reach such a dramatic leverage ratio are mostly the same as last year. Profitability continued to be affected by sourcing issues related with Covid restrictions that meant lower volumes of plasma and higher costs per liter, that were exacerbated by the current inflationary environment. This rebuilt of stocks has also been causing an increase in working capital. Gross debt has also increased by €2bn due to the completion of Biotest acquisition in 1H22, while EBITDA has only contributed by two months, synergies will take time to materialize and more important, new products from the pipeline will only start to contribute from 2024 onwards.

Despite this delicate financial situation, we believe that things should get better in 2023 for the following reasons:

1) It has appointed a new, non-family member, Executive Chairman with private equity experience. Following this appointment, communication has already started to improve as the company held its first results conference call ever (3Q22). The new Chairman was very clear in stating that he was the man in charge and the one to be held accountable for delivering on the targets.
2) The new Executive Chairman emphasized that reducing leverage was an absolute priority and that the company had some assets that could be sold without compromising the long term growth of the company. We think that the most likely option would be the sale of its 26% stake in the Chinese player Shanghai Raas that is currently valued at €1.5bn and could help to deleverage by 1/1.5x.
3) Once the share price starts to recover, the company could pursue a merger a merger of the A and B shares that could help to raise a few hundred millions to reduce debt (c.€400/500mn at YE22 prices).
4) The company's operational performance has already started to improve. In 3Q22 results, we saw an excellent acceleration in top line growth that grew by 14% at constant currency and reached historical maximums ex-Biotest.
5) Plasma collections are up 25% YTD and donor fees were already down >15% in September, both benefiting from the reopen of Mexican border.
6) EBITDA margin is still shy but already reached minimums and with the operational turnaround in place both should strongly improve throughout the next quarters.

Grifols' investment case is not absent of risks and throughout 2023 there will be some news on potential competitive menaces. In the 2Q23, Argenx will publish phase III read-out on CIDP which weighs around 10% of Grifols total sales. Even in case of success, this doesn't mean a complete disruption on GRF's CIDP sales as anti-FcRN penetration will take time and IG will continue to be used as the standard of care in many cases.

The consensus is pointing to a €1.6bn EBITDA in 2023 that at YE22 closing prices and not considering any asset sale would mean a 11x EV/EBITDA that compares with 20x of its main competitor CSL. The €1.6bn EBITDA of 2023 still doesn't reflect full margin recovery and is still not considering any contribution from Biotest pipeline that could add between €300/600mn in the near future, as stated at the time of the acquisition. At current prices, it's impossible to be indifferent to GRF's equity story with huge potential upside but acknowledging the risks BPI Iberia will continue to manage this position carefully.

Banco Sabadell

Sabadell was the second best Iberian (IBEX35 and PSI20) performer in 2022 and by far the best since the end of 2020, obviously that the latter comes from a low base after covid meltdown.

We consider that the current management have made a great job since being appointed at the end of 2020. Cesar González-Bueno, CEO, and Leopoldo Alvear, CFO, brought financial discipline, transparency in communication and focus on capital generation and asset quality.

Despite the great run that the stock made in the last two years, we believe that it is still cheap and has plenty of further room to go up. Sabadell's profitability has been improving rapidly that led it to already upgrade ROTE target three times in the last one and a half years. In May 2021, in the strategic plan, the management set a >6% target for 2023. This target was brought forward to 2022 at the 4Q21 release, and already this year, in the 2Q22 release, the company raised its guidance to >7% RoTE in 2022. We believe that they will be above 8%.

In 2023, excluding the impact of the recent two-year tax on banking sector, we think that Sabadell could be near 10% RoTE mainly due to interest rates tailwind. In the past, the bank guided for c.14% NII sensitivity for each 100bps increase in interest rates and, as a reminder, euribor 12-month rates rose from -0.5% in January 2022 to 3.3% currently. While Sabadell is not the most geared bank in terms of NII, it is the most sensitive, bottom line wise, due to a lower profitability vs peers.

Obviously, that in the current interest rate environment and probable economic slowdown, investors are fearing that asset quality will get worse and that cost-of-risk will go up and Sabadell is particularly sensitive to the cycle due to above average exposure to SMEs. Nevertheless, it's important to remind that Sabadell was still in a process of convergence as the group total cost-of-risk is at 55bps but Spanish total cost-of-risk is at 75bps. Additionally, the bank has been smoothly improving its asset quality as gross NPA ratio drop from 4.7% in FY20 to 4.1% in 9M22. NPA ratio Net of provisions is currently at 1.9%, which seems is reasonable for its risk profile. Other important arguments to believe that cost-of-risk will not explode; all Spanish banks have been stating they aren't sill seeing any signs of deterioration in the asset quality; the majority of mortgages generated in the last few years were at fixed rates and Sabadell still seats in a €650mn buffer of overlay provisions.

Sabadell has M&A appeal coming from two angles: a potential sale of TSB or the sale of Sabadell itself. TSB, its UK franchise, is primarily a mortgage bank and consequently, has been improving profitability on the back of interest rates raises but also due to cost-cutting efforts implemented until 2021. In the past, this franchise was a drag for the group's profitability but it will now deliver RoTE in line with the rest of the group (8%). Recently, Co-op Bank's CEO stated it could consider an approach for TSB after other failed attempts but that its value was much closer to book value now. As for Sabadell itself, we continue to see room for consolidation in Spain and Sabadell as a candidate to be part of it. The acquirer could extract ample synergies and benefit from Sabadell's excellent competitive position in SME and in some particular regions. In 2020, BBVA and Sabadell had merger talks but they were not able to agree on the merger swap ratio. The combination between these two banks still makes lots of sense, especially considering BBVA's lower size vs its main Spanish peers and that it aims to increase the weight of developed/emerging countries within their portfolio.

Sabadell is currently trading at c.5.5x P/e 2023 (ex-banking tax), it has above average FL CET1 at 12.5%, a good management team and several triggers to continue outperforming the sector.

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To the attention of Swiss investors:

- The marketing of the class I (EUR) is restricted to qualified investors under revised CISA Art 120 §4 in Switzerland

To the attention of French investors:

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- The French centralizing agent is Société Générale Securities Services, 189 rue d’Aubervilliers, 75886 Paris Cedex 18, France
- The prospectus, the annual and semi-annual reports and the management regulations in English language can be obtained free of charge on request from the French centralizing agent
- The KIID(s) in French language can be obtained free of charge on request from the French centralizing agent

To the attention of German investors:

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- The German information agent and paying agent is BNP Paribas Securities Services S.C.A. Frankfurt branch, Europa-Allee 12, 60327 Frankfurt, Germany
- The prospectus, the annual and semi-annual reports and the management regulations in English language can be obtained free of charge on request from the German information agent
- The KIID(s) in German language can be obtained free of charge on request from the German information agent

To the attention of Spanish investors:

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- The Portuguese paying agent is Banco BPI, Rua Tenente Valadim, 284, 4100-476 Porto, Portugal

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