Arauca Letter H1 - 2026 | September 2026

Dear Investors,

Arauca Capital reported a gross return (before any fees) of **+25,26%** for the first half of 2026 (from January 1st to June 30th). As usual, net returns vary depending on when the capital was invested in the fund. For specific details, please check your individual statements, which were sent directly by our administrator, Bolder Group in mid-July.

This was also the strongest subscription window in Arauca Capital's history in terms of number of new investors and inflows, as we welcomed new partners from different corners of the world into the fund. There is one aspect of this that is always present in my mind when welcoming new investors. Arauca´s returns in H1 2026 were higher than I would have expected, but for all our new partners, the clock starts on July 1st. I have not yet created value for them. Naturally, that creates a strong desire and pressure to bring them into the same pool of experience as our long-standing investors, where returns have been substantial. At the same time, that desire and pressure cannot and should not influence how I make decisions. Every decision is and must remain based on the fundamentals of the companies we own, combined with the size and structure of the portfolio at any given point in time. Still, I must confess that the hunger to perform and protect capital combined with the lack of excitement of past performance is exactly the attitude I believe a fund manager must always have.

The first half of the year was very active. This is not the full list, but it gives a sense of the activity: we sold our long-term holding Shelly for almost 6 times our initial investment in around three years; we bought and sold Kioxia for a 5 times return in only five months, I monetized our long-dated risk reversal in Alphabet, including the additional stock position we held for a very substantial gain. I also sold Vitalhub, and I sold ASTS in January after the stock had more than doubled from our initial purchase and enthusiasm was at its peak. Busy period indeed.

Arauca did not hold any short positions during the period. However, I did spend approximately 1% of NAV on put options on the S&P 500, with the objective of protecting the portfolio in the event of a major escalation of the war involving Iran. Fortunately, that hedge did not have to be used.

As a result, once again, the fund is holding a large portion of NAV in short, dated bonds. This reflects the level of selling we have done and the cash that has built up as a consequence of inflows. Combined with how the market is evolving, which is an aspect I will discuss later in the letter, this makes me very excited. We have significant dry powder available for the no brainers when they appear.

I also travelled to Las Vegas to attend the Planet Micro-Cap conference, which in my humble opinion is the best conference in the world for investors interested in small caps. During the conference, I had the honour of interviewing Louis Scafuri, CEO, and Assaf Korner, CFO, of Sofwave, one of our long-term holdings. You can listen to the recording here. I also joined my friend Bobby

Kraft on his podcast, where we spoke in more detail about why Arauca has been a long-term shareholder of Sofwave, and Bobby managed to dig deeper into my investment style with his interesting questions. You can watch it here.

Lastly, some housekeeping.

As Arauca grows, I need to be more deliberate about how our letters and portfolio decisions reach the outside world. There are two separate changes, but both have the same objective: to ensure that our research and decisions are shared in the right environment and with the context they deserve.

First, every account registered to receive these letters will need to be linked to an identifiable name. These letters first of all, are only for professional investors, contain substantial original research, candid reflections and detailed explanations of how I manage your capital. I have been comfortable sharing them beyond our current investors, particularly with friends of the fund and people who engage seriously with my work. However, from this distribution onwards, we will no longer accept anonymous registrations, and any registration that cannot be linked to an identifiable person will be removed. There may be a further step during registration in the future, and it is possible that the letters will eventually be distributed only to investors and friends of the fund.

Second, I will stop publishing our exits on social media. They will instead be disclosed in these letters. I have always believed that if you speak publicly about why you own a company, you should also be candid when you sell it. That candour will remain. The letters are simply the better place for it.

What remains entirely open is the thinking: the frameworks, the mistakes and the reasoning behind our decisions. What closes is the running commentary on the portfolio outside these letters.

To be absolutely clear, nothing changes for Arauca's investors of course and currently not either for people who have identifiable identities in the distribution list. You will continue to receive the same transparency you have always received, including the mistakes I made and the reasoning behind our decisions. The future changes apply only to how our work is shared outside the fund.

Part 2 – Portfolio Update

A lot of selling – AI -

<u>AI – Investments Related to AI</u>

AI has continued to change how I work. Arauca now has its own workstation with a powerful GPU, where I use local models. I also work with most of the frontier models, including Claude, Gemini, Grok, and OpenAI through its integration with Microsoft 365, alongside a handful of specialised agents I have built for specific purposes. AI is now involved in a good part of the fund's routine and administrative work, and the time and money saved are considerable, but most importantly allows me to see first hand what is happening with AI.

Research is one example. Gathering information, building spreadsheets and models, finding out consumer preferences and pulling data from the web now take a fraction of the time they used to. I have built my own workflows, including one that ranks management teams based on their past capital allocation decisions and surfaces, with verifiable sources, exactly the points I have always looked for. Some workflows, particularly involving local models remains a work in progress. The early versions of these workflows made mistakes and sometimes hallucinated, but most of that has been engineered out by requiring a verifiable source and a direct link for every important data point. I have also connected the Interactive Brokers connector to some models. This allows me among many features to evaluate option structures with correct pricing information in minutes using all the parameters I want, a process that previously required hours of going through IBKR's option chains and comparing strikes and expiries based on my parameters. I now provide the parameters in one prompt, and the model returns the tradeable alternatives. These are just a few basic examples of how AI is changing the fund's daily routine work.

The important distinction is what I delegate and what I do not regarding routine work. My role with regards to routine tasks has increasingly shifted towards checking that the workflows and outputs are working properly and improving them when they are not. But the real benefit is that I can now receive the material already organised, sit down without distractions, read it, process it and think.

For example, one of my workflows gathers everything I may need on a company, including filings, transcripts and market sentiment. Instead of spending hours finding and organising the information, I can start with the material in front of me and focus on what it means (and yes correcting errors I identify in the workflows). This clarification is very important to make. AI should help collect and organise information, but it should never replace the thinking itself. Unfortunately, I suspect that is already happening widely within the investing community. The value of AI is that it removes the work that adds little value, leaving more time for judgment.

And yet, when I speak with friends at large financial institutions, almost all remain heavily restricted in how they can use AI. Some are limited to a single model, while others are using versions that are already two years old. Adoption inside large institutions remains surprisingly slow. This tells me that AI has barely begun to reach most knowledge workers. We are still in the very early stages of meaningful adoption.

Equally, adoption may still be at an early stage, but companies are already being forced to rethink their business models and capital allocation strategies. I believe we are living through one of the most profound shifts in how economic value is created and destroyed that I have seen in my career. The scale of investment being committed is extraordinary. Sell-side estimates put total AI-related capital expenditure at $5.5 trillion by 2030, with hyperscaler spending alone projected at $650 billion in 2026 and more than $1.1 trillion in 2027. Power has become the binding constraint, and the industry is racing to add capacity measured in hundreds of gigawatts.

That speed of investment is also accelerating the rate at which industries change, which has important consequences for how I invest. Almost a decade ago, I wrote that investing should be done the way a farmer works: plant the seeds, wait and resist the urge to pull up the trees because of short-term noise. In principle, that is still right. The problem is that long-term holding assumes the core economics of a business remain reasonably stable, while AI is now rewriting them much faster than before. Companies across almost every industry but most notable among technology will either adapt, come under threat or emerge as beneficiaries, sometimes within a few years and increasingly within months. The discipline of waiting **therefore remains as important as ever, but only when the underlying hypothesis continues to survive the speed of change.**

And that is only the businesses. Their share prices move on a different clock. The market is re-rating companies to extremes, including clear AI beneficiaries, but some of today's advantages may prove temporary when the next breakthrough arrives. It is difficult to ignore an enormous move in a stock, especially when I bought it because I believed the market was missing something. Eventually, the market agrees, then gets carried away, and the risk profile changes completely. This helps explain why I have been monetising investments faster than usual. It is not primarily because my intended holding periods have changed, but because some share prices have moved far more powerfully, and much faster, than I expected in an industry where the underlying reality is changing at extraordinary speed.

But this also makes me cautious. Some of the businesses we own, or may want to own, could look very different within a few years. Memory within the AI world is a good example. In only a few years, the market went from treating it as a deeply cyclical industry to believing it had entered a new paradigm. It may eventually decide that it is cyclical again. The companies may continue doing exceptionally well, but once their share prices assume that everything will go right forever, the investment becomes very different. In those cases, there is less left to gain from being right, while the cost of being wrong becomes much larger. AI will create extraordinary opportunities, but it will also make some existing advantages disappear much faster than before. This is not an environment where I can own something and stop thinking about it. Still, I cannot imagine a more exciting time to be an investor.

From late 2023 until roughly June 2026, I believe the easiest part of the AI opportunity was available to us. Several companies were still trading at reasonable valuations before the market had priced in any meaningful benefit from AI. In effect, the optionality was free, or at least very cheap.

We first benefited through Super Micro, when the growing need for specialised AI servers was still underappreciated. Alphabet followed, when the market valued it largely as search business and gave little credit to its models, infrastructure and broader AI capabilities. We built the largest synthetic position in the fund's history when the shares traded in the mid-$150s and fully exited at around $370 during this period. Silicon Motion and Marvell gave us earlier exposure to the improving memory cycle, although we sold both too soon. Kioxia was the last, and by far the most powerful expression of that same opportunity.

The common thread was simple: demand was changing before the market had fully understood what that meant for earnings. That combination is much harder to find today. Where the path from AI investment to earnings is clear, valuations already reflect considerable optimism. Where valuations remain relatively attractive, as with Meta, the path to monetisation is less clear, at least to me today. The companies we sold may still have substantial opportunities ahead, but the optionality is no longer free, and at current prices the potential return no longer compensates me for the risk.

Alphabet deserves a brief explanation because our exposure combined shares with a long-dated risk reversal. As the share price moved substantially above the call strike in the period, the calls behaved increasingly like a large (in fact very large) synthetic holding and accumulated a substantial unrealised gain. The decision to exit reflected a clear change in the risk profile. Operating results remained strong, with Cloud growing more than 80% and Search around 17%, but capital expenditure was accelerating sharply, the balance sheet had become heavier, and the valuation particularly looking at free cash flow multiples completely changed. At around $370, the margin of safety that existed in the mid-$140/50s was largely gone. With the options also moving closer to expiry, a meaningful fall in the share price could have erased a substantial part of the accumulated gain or the totality of it if spot crosses the strike on the way down. I therefore decided to monetise the derivative position and sell the remaining shares.

From here, the picture is less clear regarding investing in AI. Many of the obvious beneficiaries have already been re-rated, and the market is increasingly treating today's extraordinary earnings as permanent.

The clearer opportunity within the AI world today, in my view, remains in power. Models and chips will keep evolving and the clarity of opportunities vary, but every data centre still needs electricity, land and water, and the infrastructure connecting them can take years to permit and build. I do not need to predict which model wins to understand what every potential winner will require.

Recent developments in Texas reinforce this view. Governor Abbott's directives require data centres to fund the electric infrastructure they need and subject new grid connections to stricter scrutiny. The practical effect is to favour projects that can provide behind-the-meter or private power rather than simply adding large new loads to the existing grid.

This strengthens the case for owners of strategic land and for platforms able to provide private power at scale. We already have exposure through **Texas Pacific Land Corporation** and **LandBridge**. Alongside them, I have initiated a smaller, higher-risk position in a pure-play private power campus that I am not yet ready to name.

Kioxia (sold)

As a reminder, we bought Kioxia at the beginning of the year at ¥19,000. The hypothesis was simple: the market was asleep to the scale of the earnings growth that was coming. I expected substantial earnings growth, but the reality ended up being far beyond even my most bullish estimates. To give one illustration, in the quarter ending June 2026, Kioxia generated operating profit of ¥1,326 billion versus ¥45.2 billion the year before. We had already sold in June before these numbers were known, so I mention them only to illustrate the magnitude of what happened. It was an extraordinary level of earnings power, well above what I had underwritten. I decided to sell at approximately ¥96,000, making Kioxia the fastest monetized five-bagger in the fund's history in around five months.

Memory stocks have seen their prices rise to multiples of where they were just two years ago because the market started to recognize a new and much higher level of earnings power. That view materialized. The market was right. However, from the new earnings base of today and the much higher share prices reached by June 2026, a completely new set of assumptions is now required to justify holding these companies. At these levels, I do not see how one can discount those assumptions without taking on a level of risk that, in my view, is simply too high. Therefore, I decided to sell the full position and watch how the industry evolves. The main reasons for exiting the positions were:

First, look at what has happened to memory inside hyperscaler budgets. Memory, including HBM, high-capacity DRAM and enterprise NAND/SSD, has gone from roughly 8% of hyperscaler CAPEX to almost 30% in only two years. That means one single input is now consuming close to a third of the capital budgets of the best-capitalized technology companies in the world. This is striking, especially because a large part of that increase has come from higher prices, not from bit-volume growth.

My problem is that extreme memory prices have never been permanent. Of course, every cycle is different, and I am not saying this one is exactly comparable to the past, in fact AI makes this cycle unique, but still a cycle, nonetheless. History gives us a clear warning. NAND flash prices fell from around $8.00 per gigabyte in 2007 to $0.71 by 2012 and then continued falling to only a few cents per gigabyte by the early 2020s. DRAM followed a similar long-term pattern. The reason is simple: when the shortage ends, prices eventually move back toward cost, and then they follow the normal long-term declines of the industry. AI can completely change the cyclicality and nature of this industry, and maybe we are under a new paradigm, but I need margin of safety, and the increase in share price removed it.

So, while the current level of earnings power is real, I have to ask how sustainable it is. At June's stock prices of memory stocks, the market was asking me to believe that a historically deflationary industry has somehow become structurally inflationary. That may be possible for some time, especially with AI demand, but it is a very demanding hypothesis. I prefer to watch from the sidelines rather than underwrite that assumption at the prices we sold.

The second point is inference efficiency. New AI architectures and compression techniques are reducing the amount of memory needed to run inference. In particular, techniques like Multi-Head Latent Attention, which have been used in leading Chinese models, reduce the size of the KV cache. Think of the KV cache as the model's short-term memory. As it works through a long document or a long conversation, it keeps what it has already processed in fast memory, so it does not have to start from zero at every step. That cache is expensive, and the longer the task, the larger it becomes. This is why inference is heavily constrained by memory bandwidth and memory capacity. If the cache becomes smaller, the system needs less memory for the same unit of useful output.

To be clear, the first impact is on HBM and DRAM, not directly on Kioxia, because Kioxia does not produce those products. But there can be a second-order impact on NAND. As context windows grew and AI systems began working through long multi-step tasks rather than answering one question at a time, engineers started using enterprise SSDs, the high-performance storage drives used in data centres, to store cached state. This storage layer has become a growing part of the demand behind today's eSSD pricing. If the total data footprint shrinks by two or four times, there is less for that layer to absorb.

There is an important counter-argument here. Cache tiering could actually help Kioxia. If data moves away from very expensive HBM and into cheaper NAND-based storage, SSD demand could increase even if DRAM demand falls. Kioxia is also investing in SSDs optimised for inference, so I do not want to pretend I know the answer, I do not. But for NAND, the net impact is much more nuanced than for DRAM.

But the key point for me is not to forecast the exact balance between these forces. The key point is valuation and discipline. At the prices reached in June 2026, the market was asking me to underwrite the idea that AI storage demand intensity will remain very high for a long time. Maybe that happens. But this is an industry where thousands of the smartest and best-paid engineers in the world are working every day to reduce that exact need. At almost 5x our entry price, I did not want to underwrite that hypothesis either.

The final point is the price we were being asked to pay, by just holding in June. At the June highs, a lot of the buying looked new to the sector. Investors seemed to be annualising peak-cycle earnings as if they were permanent and doing so with extraordinary enthusiasm. But NAND is one of the most cyclical industries that exists, as explained above. Treating this new reality as a new steady state ignores history. It also ignores what the industry itself is now doing with the money.

The supply response has started. Samsung and SK Hynix announced a major programme involving 800 trillion won for four new memory fabs in Korea, as part of much larger long-term capacity ambitions. Kioxia itself now guides to average annual capex of ¥470 billion through FY2028. None of this arrives as bits in 2026. Most industry trackers expect meaningful relief only in late 2027 at the earliest, and more realistically in 2028. That is exactly how these cycles usually work. The money is committed when profits look extraordinary and everyone feels confident, but the supply created by that money only arrives two or three years later, often when the cycle has already turned. At the prices reached in June, the market was not leaving much room for the possibility that today's extraordinary earnings may not be the new normal.

When I bought Kioxia, I wrote that I could not extrapolate these earnings forever, only for a few years out. The market started extrapolating them forever. My expectation was a triple of the stock over three years, driven by earnings. What I experienced instead was a five-fold move in five months, driven by earnings that did arrive and by an expectation that the earnings have a completely new base.

Kioxia will stay on the watchlist. This sector is violently volatile, and the same crowd that produces extreme rushes of enthusiasm also produces extreme rushes of fear. I expect to have another opportunity. If anything, this episode is a reminder of how quickly the new AI world moves and how important it is to remain disciplined.

Versabank (New Position) *written before Q3 2023 ER*

During the period, I initiated a position in VersaBank, a branchless bank founded and still run by David Taylor. VersaBank operates a highly specialised digital business to business model and does not lend directly to consumers. Instead, through what it calls the Structured Receivable Program, it funds point of sale finance companies, the businesses offering financing for things such as HVAC systems, kitchen renovations and commercial equipment.

VersaBank buys the cash flows from these loans, but the credit risk remains with the financing partner. This is the part that initially attracted me because, when investing in a bank, understanding the downside comes first. If a loan becomes 90 days overdue, it automatically returns to the partner. VersaBank also retains a cash holdback as a deposit from each partner, this provides a substantial layer of protection, and according to management, the holdback or deposit is several times larger than what the bank considers a worst-case loss scenario Borrowers in these portfolios do default, of course, VersaBank does not absorb the loss; the financing partner does. This is why the bank has reported zero credit losses throughout the history of the program.

I have spoken with David, and my impression is of a highly enthusiastic and ambitious entrepreneur who happens to run a bank and pilot aeroplanes, yes, an additional risk for us. More seriously, he has spent approximately three decades in lending with practically no credit losses and appears to be well regarded by regulators in both Canada and the United States. That regulatory trust is particularly important for another part of VersaBank's business, which I will explain further below.

Why would the financing partner retain the credit risk? Because the economics are attractive. Under a traditional warehouse facility, the lender may receive only 90% of the loan value and must fund the remainder with its own capital. That capital remains tied up until the loan is sold or repaid, eventually limiting how many new loans the partner can originate.

VersaBank changes that equation. It purchases the receivable and pays the partner the full loan value upfront, while retaining the cash holdback described above. The partner can therefore recycle its capital much faster, originate more loans and improve its return on equity, while remaining the lender of record and preserving the customer relationship. This is the reason the structure works for both sides: VersaBank gains a protected stream of receivables, while the partner gains substantially more lending capacity without giving up its customers.

VersaBank has operated this program in Canada for sixteen years. During the last five years, it grew at a compound annual rate of 27%, provided more than C$9 billion of financing to point of sale lenders and produced no credit losses. The limitation is that Canada is a relatively small market, and VersaBank is already a significant participant. One of the main reasons to own the shares today, in my view, is the United States, which the company describes as a multi-trillion-dollar point of sale finance market.

Until August 2024, VersaBank did not have its own American bank. That changed when it acquired a small bank in Minnesota and, with it, a national US bank charter. The charter allows VersaBank to gather deposits and fund loans directly in the United States, in the same currency and without taking exchange rate risk. More importantly, the economics appear better than in Canada. Management has said that its US cost of funds is approximately one percentage point lower, compared with a margin of roughly 250 basis points in Canada. It is the same product, in a much larger market and potentially at a wider spread, run by members of the same team that built the Canadian business.

The ramp is already visible. VersaBank funded US$310 million in the United States during fiscal 2025. The US SRP credit-asset book then grew from US$472.0 million at 31 January 2026 to US$604.9 million on 30 April 2026. A second ECN Capital subsidiary joined the program in July. Management has committed to funding at least US$1 billion in the United States during the current fiscal year and believes it can reach that target with the partners already in place, I agree.

Total assets reached a record C$6.4 billion, up 28% in one year, while deposits grew 31% to C$5.5 billion. Those deposits come through more than 220 broker and trustee partners and are 98% insured. Brokered money is normally considered less stable funding, but VersaBank's structure is unusual. The deposits are term GICs with no early withdrawal right, and the depositor has no direct relationship with the bank itself. As a result, I spend more time watching the rate at which the book renews as it matures, because that is what ultimately drives margins. Net interest margin on credit assets reached 2.71% in the quarter, up 12 basis points year on year and among the highest of any federally licensed Canadian bank. Revenue reached a record C$38.3 million, and the US operation, which barely existed two years ago, already contributes more than 20% of it.

The reported earnings do not yet show the full benefit, yes, our favourite unrecognized earing potential type of situation. VersaBank has spent the last two years paying the costs of becoming an American bank while the US business was still too small to absorb them. That is now beginning to reverse. In the April quarter alone, C$6.7 million of one-off charges reduced reported earnings to C$0.23 per share. Excluding those charges, adjusted earnings were C$0.39 per share and adjusted net income grew 45% year over year (although from an easier comp), the fifth consecutive quarterly increase.

Two remaining sources of noise should also disappear. The cybersecurity subsidiary must be sold or wound down before the end of September 2026 under the terms of the Federal Reserve's approval of the US acquisition. The bank has already initiated a process to evaluate strategic alternatives and has been in discussions with potential buyers. The reorganisation is scheduled for a shareholder vote on September 16. If these steps are completed, investors should finally see the underlying economics more clearly: a branchless bank growing rapidly in the United States in a niche market it totally dominates, earning wider margins, with much of the cost of getting there already paid.

There is a second engine, and it is pure free optionality today. I have followed blockchain companies for years, and the sector has always suffered from the same divide: the blockchain and crypto world distrusts traditional finance, while traditional bankers distrust the blockchain and crypto world. VersaBank is both: a regulated bank, fluent in blockchain technology and trusted by its regulators, a very rare combination.

Its Real Bank Tokenized Deposits are deposits of an insured bank, meaning they can pay interest, something US stablecoin law prohibits stablecoin issuers from doing. Management also sees them as a potential source of ultra-low-cost deposits to fund the lending business. The product is not yet commercialised, so I assign no value to it today, just free optionality.

Custody, however, has already started. VersaBank was selected by Stablecorp to hold the reserves backing its Canadian dollar stablecoin and expects to earn approximately 50 basis points on those deposits. This is important because the custody business can bring deposits onto VersaBank's balance sheet even before its own tokenised deposits are commercially launched. Over time, the opportunity could become much larger through the float generated by VersaBank's own tokenised deposits and by licensing the technology to other banks.

Stanley Druckenmiller recently said that stablecoins could become the foundation of the payment system within 10 or 15 years. I think he is right about the rails, but tokenised deposits may be more valuable to banks because they can pay interest and fund lending. VersaBank is already building the capability to exchange US and Canadian dollar tokens **(press release, March 17, 2026)**. Now, imagine if that capability could be extended to local banks in Latin America issuing tokenised deposits in their own currencies (and Versbak parterns with those banks), and remittances or corporate FX could settle directly without the correspondent chain. I spent two decades inside the FX world, so I can see the potential. This is my thought, not VersaBank's plan, although management agreed with the potential when I presented the idea. Once again, pure free optionality.

At $17, I paid roughly 1.3 times book value and less than 9 times my estimate of next year's earnings. Those estimates are based only on VersaBank's existing business and do not count the ramp-up of its US operations. Higher margins, income from tokenised deposits and blockchain custody are not included either. They remain free optionality. VersaBank is still a bank, with the obvious risks that come with it, and substantial execution is required. I like our odds here, and I truly hope VersaBank earns its place as a long-term holding for Arauca.

Sofwave (update)

There was no activity in the Fund regarding Sofwave during the first half of the year. The position nevertheless entered Q3 at a smaller weight. Given the large inflows we received, the position was diluted without us trading a single share. The allocation had simply become larger than I was comfortable with, so this was purely a risk-management decision, during subscription window. I decided to wait for the Q2 results. They have now been released and deserve an update, particularly because many of you have probably noticed the share price move lower.

The results themselves were a record. Revenue reached $30.0 million, up 43% year-on-year, net income came in at $2.5 million, and the company finished the quarter with $38.8 million of cash and no meaningful debt. Despite that, the market took the stock from roughly ILS 45 to ILS 33 in the weeks following the release. In my view, this happened mainly for three reasons.

First, growth, while still extremely high and impressive in my opinion, slowed from 46% in Q1 to 43% in Q2. Second, management acknowledged for the first time that lower-cost Korean and Chinese systems are expanding globally, at the same time that many of the key Thermage-related RF patents have effectively expired. Third, the quarter showed little operating leverage. Sales and marketing expenses grew 45%, faster than revenue itself, leaving operating margins, excluding one-off items, broadly unchanged from the prior year. That said, operating leverage remains clearly visible at the half-year level, and management has made improving it an explicit priority for the second half.

These concerns deserve to be monitored. However, I do not believe they justify a share price at the lows of ILS 33. The market has focused almost entirely on them, while paying far less attention to some of the indicators I find more important.

A word on the competition. As mentioned, in the Q2 presentation management flagged, for the first time, lower-cost Chinese and Korean radiofrequency systems expanding globally. Sofwave is not a radiofrequency system. Radiofrequency is the technology Thermage pioneered. Sofwave uses ultrasound. The first effects of this wave if there is any, should be among the radiofrequency incumbents themselves. Sofwave could feel the pressure more indirectly, through the prices patients see on clinic menus rather than through a direct copy of its technology.

Some entrants do use ultrasound and therefore sit closer to Sofwave. Sofwave heats a plane in the reticular dermis at 1.5 mm using seven beams simultaneously. However, I have not found a public copy of that exact architecture in any market during the years Sofwave has been selling, if you have, please point it out to me.

Sofwave is the premium product, cleared to market a lift, and management reports its Asian outperformance is led by Korea, the home market of the low-cost competition, you can monitor live growth regarding number of providers in Sofwave's website if you do a bit of work. But it is important to mention that the competitive landscape is more threatening than it was a year ago. Several of these entrants are large, listed, well-capitalised companies rather than cheap imitators, and one of them runs a consumables model close to Sofwave's own at greater scale. The market is behaving as though that risk has already reached Sofwave's numbers. Through June it has not. I monitor it closely and will manage the position accordingly rather than argue the risk away, now let me show you the positives, and what I see.

My investment hypothesis rests on utilisation, that Sofwave is a utilization platform company. The important question I need to answer is what happens after a system is sold. As of Q2-2026, Sofwave had sold approximately 3,100 systems and performed roughly one million cumulative treatments. On that front the quarter strengthened. Usage-fee revenue grew 51%, well ahead of total revenue, and reached 46% of sales, its highest quarterly mix to date, while gross margin rose to 76.5%.

I keep my own records on these metrics quarter by quarter because the risk is not always obvious in a business like this. Growth can look healthy while the economics underneath could be quietly changing. So, I spend less time looking at the headline and more time looking at what happens after a system is installed. Are clinics using the systems more? Is the recurring stream growing faster than the equipment base? Are there signs of price pressure where I would expect them to appear first? Is there anything in the numbers that suggests competition is starting to reach the business?

Through June, none of my indicators is flashing. Equipment revenue itself still grew 35%, usage revenue grew 51%, and the recurring portion of the business reached its highest level to date. Nothing in the numbers yet shows Asian competition reaching Sofwave's economics. The discussion today is about what competitors might do in the future, not about anything visible in the business today.

I also look outside Sofwave. The listed Korean competitors report quarterly. The private ones leave traces through launches, regulatory approvals and pricing. Korea is useful because changes usually appear there first. Through June, none of what I monitor outside the company contradicts what I see inside the numbers.

The commercial footprint tells a similar story. Between July and August, the number of providers listed on the company's public provider locator kept increasing (with notable growth in Korea), all while these low-cost producers are entering, it is a powerful message.

Meanwhile, the sell-off briefly pushed Sofwave down to around 10 times my 2028 earnings estimate, assuming growth slows to roughly 30%. That low valuation for a business still growing above 40% (though my actual estimates are around 30%), with a recurring revenue stream demonstrating the business is a utilization platform, rising gross margins, positive earnings, cash generation and a net cash balance sheet.

I think the latest market concern is less about what Sofwave is reporting and more about what the competitive landscape may look like in a few years' time. That is a legitimate concern and one I spend a considerable amount of time thinking about. For now, however, I continue to see a business expanding its footprint, increasing utilisation (the most important metric by far) and delivering record economics with best management team in the industry. Regardless, the size in our portfolio will always reflect the correct risk reward based on all emerging facts.

Shelly Group

This may not come as a surprise. After Shelly's Q4-2025 numbers were released and between February and early March 2026, I sold our entire position in Shelly Group at prices above €60. It was an excellent investment for Arauca and became a six-bagger for the fund in approximately three years. Readers of my last two letters will have noticed that, as the company became larger, I increasingly believed it needed to evolve with its new scale in many aspects. I explained the facts behind the exit in an extensive postmortem on X, which you can read here if you have not already.

As a reminder, Arauca will no longer publish information about portfolio exits on social media. These decisions and the reasoning behind them will instead be disclosed in our letters. I may occasionally state publicly that Arauca no longer owns a company, but detailed postmortems should only be expected here if I write them.

Macro-commentary and final update on the Portfolio:

The Fund started Q3 2026 with good dry powder. The safe side of the barbell, namely short-term US Treasuries and gold, represents a larger allocation today. On the macro side, US debt has now crossed $40 trillion, the deficit is running close to 6% of GDP despite a full-employment economy, and 30-year Treasury yields are hovering around 5.2%, not far from where they stood before the 2008 financial crisis. Net interest expense now exceeds the US defence budget. As Stanley Druckenmiller recently pointed out, those numbers simply do not fit together comfortably.

Inflation remains above target, yet the Treasury has started increasing its long-end buybacks in what appears to be an effort to push yields lower. The bond market itself is showing no signs of distress, which makes the timing particularly interesting. I find this combination uncomfortable. It suggests policymakers want lower long-term yields and are willing to take action to achieve them despite inflation remaining above target. In practice, this is a form of financial repression. It may work, but it can also backfire spectacularly if investors decide they require an even higher yield to compensate for inflation and fiscal risk, I need to ensure this risk is not forgotten in how I construct the portfolio.

On the bullish side, profits at the largest US companies are still growing. FactSet's latest Q2 2026 figure has S&P 500 earnings up 52% year over year. Strip out Alphabet and Amazon, whose GAAP results include large mark-to-market investment gains, and growth is still 34%. That is the seventh consecutive quarter of double-digit earnings growth, and in my view, it is what is holding the market up. Cash flow is the other side of it: the AI spenders are under pressure from capex (Alphabet and Tesla already printed negative free cash flow in Q2). Nvidia and Apple are the exceptions.

All of this is happening while AI drives the biggest revolution I have seen, with its beneficiaries and its losers. Risk needs to be managed carefully. The market prices and reprices companies very fast, which is an environment where active management should thrive, but where holding forever is going to be dangerous.

Beyond the portfolio and the usual watchlist, what has me most excited today is South Korea (and no, I am not talking about the memory names that dominate the index). Three rounds of commercial law reform have rewritten what boards owe minority shareholders, and treasury shares now have to be cancelled rather than warehoused indefinitely. What used to be a governance discussion is now being enforced through the law, and I do not think many market participants outside South Korea have fully appreciated the implications. Some investors clearly have, but I suspect the broader market still has a lot of work to do.

South Korea is a new market for me, so I am taking my time, but I believe there will be plenty of opportunities there. Access is no longer an obstacle either. Interactive Brokers now allows direct trading in Korean equities. I am considering a business trip within the next six months. If you know the Korean market, know Korean companies, and would like to join, please reach out and you might join me.

Final Comments

<u>The value of unpredictability</u>

I have never believed I hold the truth on any investment. Not once. I work with hypotheses, probabilities and facts as they arrive. Some facts change everything. Some matter a little. Most are just noise. The job is to separate one from the other and to keep **recalibrating**. That is why I use the word investment hypothesis rather than thesis. A thesis sounds too fixed. A hypothesis can be tested, improved or discarded.

The passage of time matters as well. A small issue within a company can be perfectly acceptable in a tiny position or in a company that is still early in its development. The same issue becomes much harder to ignore if years pass and nothing changes. Facts do not exist in isolation. Time changes them too.

If I want to protect my judgement from overconfidence, attachment to an idea and all the other biases we carry, I also need to work very hard on the environment around me. The information we consume matters, but so do the people with whom we discuss it and the amount of attention we give them. The right environment helps me recognise when a fact matters and, more importantly, when I may be wrong.

I have spent more than a decade and a half building a network of people whose judgement I trust in this field. With some, one conversation a year is enough. With others, I may speak three times a day. What they have in common is integrity and independence of thought.

Most importantly, I cannot predict what they will tell me after something happens. When a new fact arrives, I genuinely do not know what they will say. They do not tell me what they think I want to hear, and they do not defend a position as if their identity depended on it or are permabears/bulls. They look at the facts, challenge the idea and, if the hypothesis no longer holds, move on or point out aspects I have not looked upon. Disagreeing with these types of people is truly a pleasure, and a lot of wisdom comes from those interactions.

What makes those discussions valuable is that the focus remains on the substance rather than the messenger. The objective is not to win an argument, defend an identity or protect a previous opinion. The objective is to get closer to the truth. That sounds obvious, but it is surprisingly rare. Once the discussion becomes something different rather than the facts, very little learning tends to happen.

An environment becomes dangerous when the reactions of everyone in it can be predicted. If I already know who will be bullish, who will dismiss the concern and who will defend the position regardless of the facts, I am not receiving new information. I am only hearing existing views repeated back to me and witnessing the human bias I my self want to avoid, dangerous situation.

Protecting the right environment does not mean surrounding yourself with people who agree with you, that is fatal in this business. It means surrounding yourself with people who are willing to follow the facts wherever they lead, even when those facts contradict a long-held opinion. I have spent years trying to build exactly that environment around me. Looking back, I believe it is one of the main reasons I have been able to change my mind when the evidence changes rather than become attached to an investment, a narrative or my own ego. The goal is not to be consistent with what I said yesterday. The goal is to be consistent with the facts available today, with my mental models, and with the actual objective of Arauca: protect and compound capital.

The solution is to become more selective about where I spend my time and attention. I want to remain open, continue listening and expose myself to views that challenge mine. But not every opinion deserves the same amount of attention, and not every disagreement deserves a response. Facts should be the starting point. I have little interest in spending time arguing whether the sky is blue. What interests me is understanding which facts matter, what they mean and whether they change the hypothesis. Therefore, I need to be careful about how much of my time and attention I allow those discussions to consume.

Successful investing requires much more than finding the right companies. It requires knowing what matters, what does not, and how long each fact should matter. It requires the patience to hold when the hypothesis remains intact and the humility to change your mind when it does not. Above all, it requires the ability to think clearly.

The older I get, the more convinced I become that who you keep around you is one of the most important investments you will ever make.

Dear Partners, thank you for your trust. As usual, the biggest thanks always go to Laura, Graciela and Joséphine.

Yours truly,

Jean Philippe

Jean Philippe Tissot
Founder of Arauca Capital

Jean Philippe Tissot full track record 13 years

	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	*-19.54%*
Arauca Capital	**2023	*+30.65%*
Arauca Capital	**2024	*+8.98%*
Arauca Capital	**2025	*+31.34%*
Arauca Capital	**2026 H1	*+25.26%*
	CAGR	***19.16%***

** Arauca Capital was launched in July 2021 post the family partnership*
*** Gross returns do not include fees*

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