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October 21, 2025

Dear Partners, Friends, and Family,

Enclosed you will find our quarterly update of our funds and our business. This letter is six pages, including some discussions on our holdings.

We welcome any constructive feedback or comments that you may have on our letter.

Best regards,

Edwin Lugo
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EL2 Capital LLC
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International Small Cap Focus Fund (*ending September 30, 2025*)	**Gross**	**Net**	**MSCI EAFE Small Cap Index**
Quarter	-4.24%	-3.70%	+6.32
Year-to-Date	+16.53%	+13.99%	+29.00%
Since Inception Cumulative*	+72.31%	+62.72%	+29.62%
Since Inception CAGR*	+16.72%	+14.85%	+ 7.67%

**Performance is for 3 years and 6 months - Start Date as of April 1, 2022.*

Global Opportunities Fund (*ending September 30, 2025*)	**Gross**	**Net**	**MSCI World Index**
Quarter	-6.54%	-6.38%	+ 7.37%
Year-to-Date	-0.49%	-1.20%	+17.85%
Since Inception Cumulative**	+41.81%	+39.13%	+74.44%
Since Inception CAGR**	+11.99%	+11.30%	+19.75%

***Performance is for 3 years and 1 month - Start Date as of September 1, 2022.*

CAGR = Compound Annual Growth Rate since the inception of the fund.
Please note that performance among different partners may vary depending on their initial investment time.
Fees are calculated using our management fee of 1% and performance fee of 15% after a 6% return.

Any performance discussed in this letter represents past performance, which does not guarantee future results. Current performance may differ from the figures shown. The Fund's investment return and principal value will change with market conditions.

Portfolio Update
As of this writing, we have 12 companies in the International Small Cap Fund, and 13 companies in the Global Opportunities Fund, with 1% and 9% cash/gold, respectively. With our residual cash we included gold as part of our cash reserve. We believe the largest short-term risk is a debt default by one of the major developed countries, particularly the US. We don't know when or if it may happen. But in our opinion this uncertainty has increased, and our residual cash/gold mix will help offset its potential impact. If the markets were to fall, or one of our companies becomes more attractively valued, we plan to use these reserves to buy more of our quality businesses.
This quarter we underperformed primarily due to the market's fear of artificial intelligence (AI), replacing mission critical software for businesses and government agencies. This is despite our companies having reported excellent figures and have good prospects for the rest of the year. Thus, our first reaction to these fears is that they may be overblown given the dynamics of the industry and the hype surrounding AI. Nevertheless, we are carefully looking at these potential AI changes, and we discuss them in the next section.

Artificial Intelligence and the Potential Impact on our Technology Holdings
Generally, the concern from the end of July 2025 for vertical market software (VMS) companies is the impact of AI on the industry. This includes our investments in Constellation Software (CSU), Topicus (TOI), and Lumine (LMN). More specifically, TOI and LMN are spinoffs and are largely still controlled by CSU. TOI is more European focused,

headquartered in the Netherlands, and LMN is focused on the communications and media sector globally. We will focus on CSU as it represents our holdings in the sector. In essence, the fear is that AI could possibly take revenue away from these software makers and move it toward AI-focused businesses. In addition, AI operators can potentially disrupt the process of creating software, specifically doing tasks for CSU customers quicker and easier, possibly replacing CSU's software systems. Blurring the picture further, there is much misinformation in the marketplace today regarding AI and its impact on the industry. Separately and to make matters more complicated, founder and CEO Mark Leonard had to step down for health reasons. He was replaced by Mark Miller who has been working with him for about thirty years and was part of the first acquisition that CSU made.

Stepping back, CSU is a collection of over 1,200 software businesses in different geographies and in different industries. Each being number one or two in its sub-industry providing mission-critical software with more than 70% of its sales recurring. More generally, CSU has been a serial acquirer of these businesses for over thirty years, following a disciplined approach with a targeted 25% return on investment (slightly lower for larger acquisitions). As a result, the management team has created immense value using these guidelines for decades, despite several revolutionary changes to the computer industry during this time. This includes the advent of the internet, the proliferation of smart phones, and the movement of data and software to the cloud. However, the concern today is that AI could be game-changing for the industry. We discuss the following questions that address our most serious concerns.

<u>Can CSU's customers change their critical operational software to an AI-based alternative that may be more attractive?</u>

For CSU's customers, the switching costs are very high, some have compared it to "removing your spine". Essentially, CSU's core operating software for its customers, which includes both private businesses and government agencies, usually has several types of critical functions integrated into it. For example, CSU's software may be combined with customer relationship data, which is important for sales or tracking participants in a government agency, and it may be further combined with enterprise planning software, which ties in finance, human resources, and manufacturing. Moreover, these customers have been working with their VMS providers for many years, and in some cases for decades. They stay long-term customers because CSU provides the tools to integrate the latest technology into their core operating software. For example, when a small municipal school district in the Netherlands wants to upgrade their software to allow mobile phone access, CSU would provide that feature. In instances where there are core software changes, it usually requires a team of developers and integrators to make the change over and then test the system, for which the costs can be quite high. This is in addition to the disruption risk. Thus, CSU customers would think twice before making any core software changes. More practically, we have learned that businesses, including our own, tend to adopt new technologies by layering on top of what we have in place. For example, we found that many businesses still have servers on-site despite the efficiency of the cloud, particularly government agencies, not to mention mainframes in some cases.

<u>Customers will likely demand AI modules. How will CSU adopt AI?</u>

Today, CSU has taken AI much more seriously and its adoption internally. This includes developing large language models for businesses to harness their data more efficiently and analyze it to service their customers better. In fact, CSU has conferences two to four times a year to share and discuss new technologies and best practices amongst their many subsidiaries. For example, in 2017 and 2018, machine learning became a popular tool (which is a component of AI) to improve software functionality, and CSU embedded these machine learning algorithms into "demand response transportation software" to speed up scheduling changes. Really, it is the responsibility for each independently run subsidiary to respond to AI in its specific subsegment, partly because AI affects each industry differently. CSU's philosophy is decentralization and that its local subsidiaries best understand their local customers' needs. So far, the response from CSU's customers, particularly government agencies, has been to wait for AI to mature and to address any safety issues, particularly the dissemination of proprietary information and data. As a result, there hasn't been much interest beyond chatbots and co-pilots from customers so far. In the past, CSU typically gave a few years to see how a particular technology develops to determine its usefulness with customer workflows. More generally, modules and features in the past have enhanced the VMS provider's ability to increase functionality for the customer and save costs, further solidifying customer retention.

<u>What about the competition?</u>
Many startups are focusing on AI but are more horizontally focused (across industries) and do not have the expertise in the various sub-industries that CSU specializes in, thus allowing CSU's subsidiaries to maintain their advantages. Ironically, the rapid pace of new AI companies coming into existence brings more acquisition opportunities to CSU in the future. Typically, the company would give about five years before acquiring a business with new technology, unless it was given as part of an acquisition. Operationally, some have claimed that CSU will likely not experience much of a boost in organic revenue growth from AI because at most it is an extra feature that is provided to customers for an additional expense. However, over the next few years, AI may reduce development and testing costs. For example, CSU has found that AI maintains the same quality in coding while reducing man hours. Some in the industry believe it will be a driver to even greater profitability. This was the case when VMS companies moved their clients from a license model to the cloud.

In summary, CSU may have been slow to respond to AI initially. Certainly, there will be some segments of their business affected by this new technology. However, with their efforts to share best practices among hundreds of subsidiaries globally, it will likely be more beneficial, rather than detrimental for them in the long run in our opinion. Nevertheless, we will continue to monitor these developments closely. Other operational challenges that CSU may be facing in the years to come are more related to size, hubris, and staff turnover, which we are more concerned about.

"We tend to be fast followers. So, our business leaders, particularly our better business leaders, are usually quick to respond to changes inside of their markets due to moves their competitors make or new entrants make into the market."
– Constellation Software CEO Mark Miller, October 1, 2025, Conference Call

The Thinking Process before the Investment Process
We use mental models as short cuts to deal with reality, and they act as a basis for our investment process. More generally, this is part of the reason why stereotypes exist, whether we like them or not. It is a quick way to come up with conclusions and, in the process, save brain power. Humans and animals have shown to take the easy path to save energy, mentally and physically. Nevertheless, these models are helpful in keeping us from reinventing the wheel, but they are not reality. The key is to adjust our models as the world changes. As we evolve at EL2 Capital, we ask what drives the creation of our mental models. Afterall, good mental models can lead to performance and thus are the building blocks to an investment process. Charlie Munger discussed them frequently. In fact, learning drives the creation of good mental models. But what are the factors to learning? We found that it is not only intelligence, but also emotions. Brilliant work by Mary Helen Immordino-Yang, neuroscientist at University of Southern California, explains, *"although its influence during learning may not be openly visible, emotion stabilizes the direction of the learner's decisions over time, helping the learner to steer toward strategies that have worked well in similar situations in the past. In this way, implicit emotional memories are an integral part of learning and thinking."*[1] This is part of the reason why mistakes are so valuable to forming our investment strategy. In other words, our mental models get shaped by emotions we experience in the market. Fear, greed, and pride come to mind. But how do we harness these emotions to build proper mental models that translate into success? We found that these emotions become stamped onto our psyche and upon reflection we adjust our actions to improve our ability to win. Overall, emotional situations are easier to recall. They have a lasting impact on our thinking and future actions.

[1] Mary Helen Immordino-Yang, "Emotions, Learning, and the Brain", p.93

Emotions

↓

Learning

↓

Mental Models

↓

Investment Process

↓

Performance

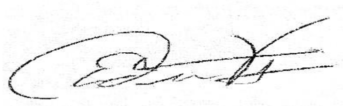
For instance, we have certainly experienced anxiety when markets are falling, but only to see markets rebound thereafter, whether it was the 1987 flash crash, 1998 emerging market crisis, or the great financial crisis in 2008. Our lesson was derived from fear combined with the desire to do better; thus, we created the mental model of staying invested and buying more, despite our nervousness. Another emotion is pride where for example we feel we can predict economic outcomes and then get recognition for our intelligence. This is further reinforced when we frequently get asked for our view on the economy. However, we are almost always wrong on these predictions. We then reflect on our embarrassment and damaged pride. Thus, to improve, we decided not to predict or take positions that reflect our economic forecasts. Speaking of self-esteem, we love searching for data that supports our investment thesis, also known as confirmation bias. It is wonderful to live in our bubble, but we know it is flawed and may deviate from reality. We therefore created a mental model that tells us to test these feelings and reign them in by constantly verifying our analysis and reminding ourselves that we could be wrong (we have already saved lots of money from this mental model). Moreover, we remind ourselves that probabilistically 60% of the stocks underperform the T-bill rate[2].
In summary, we realized our emotions are essential to creating mental models that then become the foundation of our investment process. We used to think that investing should do away with emotions, in other words to be more rational. However, we learned that they are a valuable component to our success.

[2] Henrik Bessembinder, “Do Stocks Outperform Treasury Bills?”, May 2018.

Business Update

We added two new partners in the last quarter, and we welcome both. We are honored and humbled by their support and confidence in us to help build their net worth. We certainly plan to work hard and stay focused on the long-term delivering the returns they expect, with our assets working alongside theirs. Going forward, we will continue building strong relationships with our potential partners.

Sincerely,



Edwin Lugo
Founder and Managing Partner
EL2 Capital LLC

P.S. For more details, please visit our website at www.el2capital.com. You can access recent quarterly reports and our annual letters. For serious inquiries and/or documents to invest into the International Small Cap Focus Fund or the Global Opportunities Fund please email me at elugo@el2capital.com or text me anytime at 410-258-1452.

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