October 2017

Dear Investor,

THIRD QUARTER OF 2017

My primary communication with you will be through an annual letter. However, I plan to use quarterly updates to introduce new investments, and to discuss any other updates of the Capensis Capital business. During the initial quarters, these updates will be extensive as I'll explain the reasoning behind purchasing new investments for your portfolio.

Please read this letter in conjunction with your quarterly investment statement: the statement contains all financial information relevant to your account. I invite you to contact me if you'd like to further discuss your portfolio, or if you have comments on anything I have written.

Operational Update

It's a pleasure to again welcome several new investors to Capensis Capital this quarter. I hope this will be the beginning of a fruitful relationship with you. I recommend you read my previous letters to help you understand both the Capensis Capital philosophy and the reasons for choosing the investments for our portfolio.

The business is making steady progress on the long-term goals as discussed in the introductory letter.

Portfolio Updates

1. Cash

Cash remains the largest holding in the portfolio. As previously explained, cash is my default position: the cash level is determined by the opportunities that I have found for investment. Our cash position will fluctuate with the purchase and sale of securities. I do not specify a target cash level for the portfolio.

Additionally, I expect the portfolio to have some cash available most of the time. The mandate, according to which I manage the accounts, is a flexible one (in other words, I am not bound to be fully invested). Consequently, I do not feel pressured to rush to invest all capital during periods in which the markets continue to hit all-time highs. Having cash adds resilience during difficult times, and the ability to act quickly when opportunities arise.

2. State National Companies (SNC)

Please refer to the 2017 Q2 Letter for background information about SNC.

Markel transaction

Shortly after the release of my previous letter, SNC announced that it had entered into an agreement to sell its business to Markel Corp (a larger US speciality insurance and reinsurance company that I will write about in the future) for the cash price of $21.00 each.

It was always possible that SNC might be sold to another business and rumours originating in May 2017 suggested that an investment bank was soliciting offers for the business. I was, however, unable to confirm the whispers and the company told me that they "do not comment on speculation".

The potential for a deal was never a driving factor in my analysis. I estimated the value of SNC, based on a number of scenarios, implying share prices ranging from $14 to $25. This allowed for ample upside potential vs the downside risk when I began buying shares for our accounts.

When the Markel deal was announced, the SNC share price quickly increased to $21. This was a bitter-sweet moment for me. It was sweet in the sense that the deal quickly generated much capital value, and the acquirer was Markel, a business I regard very highly, but it was also bitter as the transaction price did not reflect the full potential value of SNC.

A second bite of the apple

This quarter saw a higher level of hurricane activity in the Gulf of Mexico than the market became accustomed to. At the height of the Hurricane Irma worries in September (following Hurricane Harvey's destruction in Texas), insurance companies were sold off across the market. Even SNC fell in sympathy, although to a much lower extent. I used the resulting decline to maximise our exposure to SNC as I saw an opportunity to increase the returns available from the cash in your accounts.

While the absolute upside to the offer price was just over 2%, I estimated that we'd earn an *annualised* return of between 6% and 20%, if and when the Markel transaction settled. "If" is the operative word in the previous sentence, as there is always a risk that a deal might fail to close. However, in this case, I have a high level of confidence in the deal closing because:

- Markel, as the acquiring party, has enough cash to purchase SNC without encountering financial difficulties
- SNC management fully supports the deal, and the major shareholders have signed irrevocable agreements to vote in favour of the proposal
- The deal makes commercial sense
- SNC is fairly tightly held and a 50% majority of shareholders is required for the deal to pass

Should the deal fall through, the second purchase price is still below what I regard as fair value for the business, albeit with a much lower safety margin.

Investing in special situations like this is not a primary focus of my strategy, but, while the cash levels in the accounts are high, it is one method that I will employ to enhance returns.

In my annual letter I expect to do a post-mortem analysis of the SNC investment, and to discuss the comparative roles of skill and luck in the final outcome. However, at this stage, I would like to thank two of my investors (for whom I used to work in a previous life) for the role they played in increasing my understanding of SNC's lines of business. My network of investors is immensely valuable: I hope to make further use of your knowledge and skill to increase the value of the portfolio.

3. L Brands (LB)

L Brands is a new holding that was purchased this quarter. While the company might not be a household name, its retail brands certainly are. LB's family of brands includes Victoria's Secret, Bath & Body Works, Pink, La Senza and Henri Bendel.

LB is a market leader that generates attractive returns on capital invested. In the USA, Victoria's Secret is the number one lingerie brand, and LB dominates many beauty categories through Bath & Body Works. The company has significant international growth potential, particularly in China.

LB's founder-CEO Les Wexner owns some 16% of the company, and leads an experienced management team. Wexner is the longest serving CEO of a Fortune 500 company, having run the company since 1963.

Two years ago, LB was a market darling, trading at nearly $100, with an earnings multiplier of 25. Its share price has since lost around 60% and has been derated close to 12 times earnings. LB started to show revenue declines in 2017, following consistent growth it achieved since the global financial crisis ended. Several factors contributed to these declines, some of which were attributable to management decisions. The company decided to relinquish its swim and apparel business, which contributed around 9% of its 2015 revenue. It also changed its promotional strategies, and discontinued catalogue distribution. I think it is fair to say that these actions had larger than expected impact on sales, but I appreciate that the management team decided to take all its medicine at once.

In addition to management actions, the stock suffered from negative sentiment towards shopping malls, and the risk that Amazon.com poses towards retailers in general. I understand that LB has the flexibility to exit leases in underperforming malls, although around 99% of its shops are currently cash-flow positive. In addition, LB experiences a smaller impact than most businesses from the Amazon.com threat because of its strong brands, effective online presence and control of its own distribution.

My investment thesis is that the company's negative aspects are fully reflected in the current share price, and that it will be able to return to a level of growth, albeit likely lower than in the past. This should lead to attractive intrinsic growth of the business, and might someday be reflected in a higher valuation multiplier.

Several of you were involved in the research informing our L Brands investment and I thank you (or your significant others) for helping me to better understand the lingerie and personal care markets.

4. Capital One (COF)

Another new holding is the US bank, Capital One. The company is a technology business that originally started out as a credit card issuer, but has since grown into a full-service bank. What sets COF apart is its use of an information-based strategy throughout its operations. This strategy was developed over the past 20 years, and provides COF with some of the highest quality data for decision-making in the industry.

Richard Fairbank is the founder-CEO of COF, and has significant skin in the game. I think this is a valuable asset in any business, but is most important for geared businesses like banks. In my opinion, it contributes to the long-term thinking employed by COF, and its willingness to zig while others are zagging. Examples of this include COF's insistence on growing its auto lending book following the financial crisis and its willingness to walk away from credit card opportunities in which risks and rewards were out of sync.

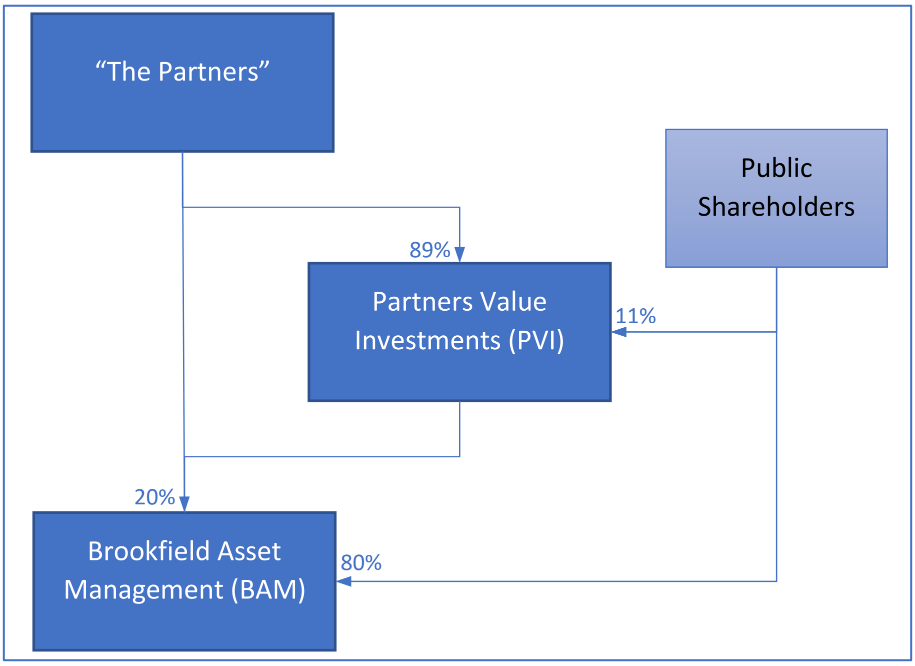
In COF and LB, you might see a common strategy of investing in businesses with a founder-CEO at the helm. In my previous letter, I discussed SNC which is also managed by its founders. When coupled with BAM and Berkshire Hathaway, a significant portion of your portfolio is invested in companies managed by their founders and/or by CEOs with long term tenures and significant personal holdings in their businesses. It's useful to repeat the obvious: alignment of interest is valuable in the investment world, especially when coupled with a long-term outlook.

5. Partners Value Investments (PVI)

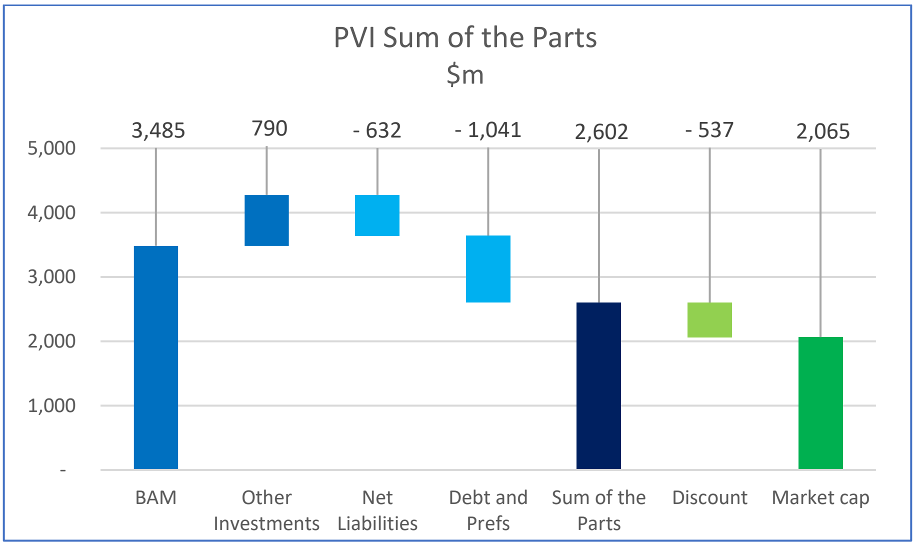
PVI is a limited partnership listed in Canada. Its main investment is a 9% holding in Brookfield Asset Management (BAM). Please refer to the 2017 Q2 Letter for background information on BAM.

As shown in the diagram, PVI is one of the instruments through which the current and previous executives of BAM ("The Partners") exercise control over BAM. Collectively, these Partners own or control 20% of BAM, and can elect 50% of its board. Around 89% of PVI is held by the Partners, making PVI illiquid and uninvestable for most institutions, but an interesting opportunity for a patient portfolio.

Ground Floor, Liesbeek House, River Park, Gloucester Road, Mowbray, Cape Town, 7700 | POBox 51868, Waterfront, 8002, South Africa | Tel: +27 (21) 680 5155
email: info@capensiscapital.com | www.capensiscapital.com
Capensis Capital (Pty) Ltd. Reg No 2016/382805/07. Authorised financial services provider. FSP 47674
Director: HP Vermaak



PVI is trading at a discount of more than 20% to its sum of the parts valuation (see the chart below), so I see it as an attractive entry point into BAM. However, the position is sized mindful of the additional leverage in the business.



Conclusion

It continues to be a pleasure and a privilege to manage your capital. As always, I invite you to contact me if there is anything you would like to discuss.

Your partner in long-term value,

Henno

Disclaimer

This document is intended for the clients of Capensis Capital (Pty) Ltd. All data provided by Capensis, unless otherwise stated, is current as at 30 September 2017.

Capensis Capital (Pty) Ltd is an Authorised Financial Services Provider, regulated by the South African Financial Services Board. Registered office: Ground Floor, Liesbeek House, River Park, Gloucester Road, Mowbray, Cape Town, 7700

More information about Capensis can be found at http://www.capensiscapital.com.

The value of your investments and the income from them may go down as well as up. It is possible that you may receive less than you invested. Past performance is not indicative of future performance.