April 2022

Dear Investor,

FIRST QUARTER OF 2022

This quarter marks the fifth birthday of Capensis Capital. Five years still places us firmly in the early years of our dream, so we remain grateful to all of you who decided to join us so early on the journey. We wrote our introductory letter that "our aim for Capensis is to build our corporate home for the next 40 years or more. We love what we do, and we hope to continue doing it for decades to come".

Thank you for making this dream a reality.

Investment Performance

Over the past five years, the portfolio has grown at 7.9% per annum. This compares to the benchmark of US inflation + 6% with increased at 9.4% per annum.

Return	Capensis Capital		Benchmark (US inflation + 6%)	
	Total	Annualised	Total	Annualised
Since inception (5 years)	+46.0%	+7.9% p.a.	+56.5%	+9.4% p.a.
Last 3 years	+39.5%	+11.7% p.a.	+34.5%	+10.4% p.a.

Source: Interactive Brokers, US Bureau of Labour Statistics, Capensis

This letter is designed to be read in conjunction with your quarterly investment statement, which contains all the financial information. As always, feel free to contact us if you would like to discuss your portfolio.

Navigating the waters

Investors can learn more than a few lessons from surfers. Perhaps the most important is that both oceans and markets are complex and can be unruly. It's impossible to predict or control them, so our focus is on building a sturdy and functional craft to navigate different and difficult conditions. We do this so that you can focus on holding on, even when seas are rough.

One of the lessons you will likely learn before paddling out to the backline for the first time, is this: Hold on to your board. Regardless. If you let go, the board becomes your worst enemy because it can knock you or a fellow surfer. The pull of the wave on a board dangling from your ankle leash puts more pressure on the leash, and it can pull out the board.

It is especially tempting to dump your board and dive down when the waves get big – exactly when you should be holding on tightest. In the same way, you should hold on to investments made with managers you trust, especially when times are tough (as is currently the case in many markets) and your portfolio may not be faring as expected. We will shape the board as best we can, but your job is to hold on, regardless of conditions.

Building a better board

We're careful when choosing what to build with, setting strict standards for the quality of our investments before we consider prices. We also know how important it is to shape: to continuously refine our portfolios, reassess position sizes and scrutinise for unintended correlations. And while different variations will cater to different needs, all our funds are designed based on the same principle: to maximise the odds of achieving their benchmarks.

This means that we design boards to maximise the number of rides over your life. We do not look at the forecast conditions and then shape for those conditions. So rather than a few fast rides, our approach aims to compound

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Director: PJ Bosman, HP Vermaak

your capital over time as your investment works in different conditions. If we are too focused on analysing forecasts or trying to make our own, we can make very big mistakes.

We try to build boards that won't snap even in the roughest of times. In investments, this means not paying too much for securities. This could include securities issued by a strong entity but for which you are expected to pay too much, or securities from an entity that is of far lower quality than reflected in the price. Either is likely to result in permanent loss of capital.

Current conditions

Stubbornly high inflation in many countries (like the US, UK and much of Europe), is forcing the hands of central banks. Inflation is being driven by various factors, including supply chain disruptions and the war in Ukraine. It means that central banks need to implement monetary policy tightening, which may involve reducing asset purchases and hiking interest rates. This tends to reduce the demand for goods, including investments, which places pressure on prices and could be an important contributor to the current decline in security prices in these countries. It has also resulted in significantly higher bond yields globally, leading to one of the worst quarterly bond market performances in history. Bond yields set the discount rates for all other assets and rising bond yields have a commensurate negative effect on prices.

Shaped by the energy of the ocean

Although your board was not shaped only for current conditions, it was shaped to be good even in current conditions. Your portfolio has positions that would benefit from higher inflation and others that would thrive if inflation declined. In both cases, we feel the assets are offering significant value – which provides additional protection. Similarly, rising interest rates will benefit holdings such as our financials (First Republic Bank and some of the insurers), while more moderate rates will support consumer spend and could boost investee companies such as kitchen supplier Howdens. In some cases, we will be heading for the lip of the wave in the hope of busting out an air (like with Twitter), while in other cases we will bottom turn to ride the wave for a long (and optically unexciting) time, like with British American Tobacco.

As we have used normalised interest rates when approximating the values of the businesses in which your portfolio is invested, it is important to note that the prices of shares could fall as the tide of easy money goes out. However, they should do well in the long term as growth in profits pulls prices up – but this could take time.

To illustrate: If a company is trading at a multiple of 20 times annual profits and this drops to 15 times, the loss of capital is 25%. If the multiple remains at 15 times, how long will it take to recover that capital? Well, if the company can grow its profits at 10% per year, you will recover your loss after three years and double your money over 10 years. This excludes the benefit of any dividends, which will result in an even better outcome. In cases where we have paid 20 times earnings to invest, we believe the companies will grow faster than 10%.

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We believe you're in for a rewarding ride.

Operational Updates

This quarter we welcome Simone Blanckenberg to the Capensis team. She has many years of experience in all the different parts of the asset management industry. Simone is also the chief operating officer of Granate Asset Management and will be taking over more of the administrative duties going forward. Feel free to contact her at simone.blanckenberg@granate.co.za.

Portfolio Updates

The main detractors to performance were MEI Pharma and your investment in the semiconductor sector while Berkshire and Markel contributed positively.

We are encouraged that several your companies are making use of their lower share prices to repurchase shares. During the quarter, the following companies instituted new or additional authorisations:

- Howden Joinery: GBP250m authorisation equal to >5% of the market capitalisation on announcement
- Exor: EUR500m (3%)
- BAT: $2bn (2.6%)
- Twitter: $4bn (>10%)
- AIA: $10bn (8.3%)
- Applied Material: $9.2bn (7.7%)

MEI Pharma

MEI Pharma is a late-stage pharmaceutical company which focuses on developing cancer therapies. Its main drug candidate is zandelisib, which is being evaluated in a number of clinical trials against certain blood cancers. Towards the end of 2021, the company announced the successful conclusion of a phase 2 clinical trial which indicated that zandelisib was both safer and more effective compared to all the other approved candidates in its class. This increased the likelihood of an accelerated marketing approval to begin to market zandelisib while the final confirmatory phase 3 trial was continuing – a trial which MEI initiated before the results of the phase 2 trial was announced. Unfortunately, the FDA recently announced that they will no longer considering accelerated approval based on phase 2 data for this class of medicine and that they encourage MEI to continue with its phase 3 trial. This was disappointing news as the company was in the process of building out the operations for the commercial launch of zandelisib. The company remains confident on the commercial value of zandelisib, but the FDA decision means that it could be up to another three years before it starts to earn revenues from zandelisib. The market reacted negatively, and the company is currently trading below its lock-down lows and valued at less than the cash on its balance sheet. We have decided to maintain your position in MEI Pharma as we see several scenarios in which it could ultimately be an attractive investment.

Conclusion

It continues to be a pleasure and a privilege to manage your investment. Please do not hesitate to contact us if you have any questions regarding your portfolio.

Your partners in long-term value,

Alex, Catherine, Henno, Paul and Simone

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Disclaimer

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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.