

October 2019

Dear Investor,

THIRD QUARTER OF 2019

Although our primary communication is an annual letter, we share changes to your portfolio and developments at Capensis Capital on a quarterly basis.

Investment Performance

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.

Portfolio Updates

1. Cash

Cash remains the largest single holding in the portfolio. As previously explained, cash is our default position and we allocate from cash as and when we find investment opportunities matching our specific investment criteria. Your cash position will fluctuate with the purchase and sale of individual securities and not according to some predetermined target level.

Additionally, we expect the portfolio to have cash available most of the time. The account is managed according to a flexible mandate which means that we are not bound to being fully invested. Cash adds resilience during market downturns and the ability to act quickly when opportunities arise.

2. Teekay Offshore

We wrote about the developments at Teekay Offshore in our previous letter.

On 1 October the Teekay announced that Brookfield increased its offer price to take the partnership private. The price increased by 48% from \$1.05 to \$1.55 per unit and unitholders will have the option to remain invested in the unlisted partnership.

While this is a much-improved price, it remains substantially below our estimate of the intrinsic value of the business. We, however, decided to sell your shares in the market following the announcement. Brookfield is in a very strong bargaining position and a further price increase seems very unlikely. Furthermore, the prospect of remaining invested was not appealing due to the limitations around tradability and voting rights it offered.

We will have a full review of the investment in our annual letter. For now, the whole experience was ultimately negative and raised several questions around the actions of Brookfield as a majority partner in the public markets. Make no mistake, Brookfield is executing a good transaction for its investors and shareholders (which is to our benefit) but ultimately the company often monetises mature investments through public offerings. We fear that similar actions might end up being to the detriment of Brookfield in the long run.

3. Burford Capital

Burford had an eventful quarter.

Burford's second largest investor was a fund managed by Woodford Investment Management. Following high levels of redemptions, the fund manager decided in June to suspend redemptions in the fund to allow for a more managed liquidation of a large number of illiquid holdings in the fund. The expectation that the fund would sell its holding in Burford caused the share price to decline early in the quarter.

In August, a highly regarded hedge fund released a report making a series of allegations around the accounting and governance at Burford. It also suggested that the company might have cash flow and solvency issues. The share price fell materially resulting in significant profits for the hedge fund which held a short position in Burford.

We reviewed all the allegations made by the hedge fund, as well as the actions of management in addressing the concerns raised. It is our conclusion that the allegations made were mostly without basis and sensational in order to create panic.

Unfortunately, the share price decline and the coinciding fall in the prices of the company's listed bonds influences the value of the business. These price moves, if sustained, increases Burford's cost of capital. This is an important consideration as the company is dependent on the capital markets in order to fully capitalise on its significant opportunity set. It is possible that this situation might recover, but for now we have reduced our estimate of what the ultimate fair value of the business.

Having said all this, we did reduce your exposure to the business following the unexpected outcome of the election in Argentina. Burford's largest asset is a multi-billion dollar claim against the Argentine government and the primary elections held in August indicated that there will likely be a change in leadership in October. The polls indicated a move away from the market-friendly policies of Mauricio Macri and towards the populist ideals of Alberto Fernandez and Cristina Fernández de Kirchner. The Argentine currency and investment markets sold off substantially following the results and the overall ability of the state to solve its economic troubles reduced. As such, we reduced our estimate of the likely recovery on the claims as well.

We note that the final outcome of the election was a win for Fernandez and we will closely follow the economic policies of the new regime.

Conclusion

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

Lastly, we also wish the Springboks the best of luck in Japan!

Your partners in long-term value,

Henno and Paul



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 2019.

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

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