CAPENSIS CAPITAL

April 2018

Dear Investor,

FIRST QUARTER OF 2018

Although my primary communication with you is an annual letter, I also like to write these quarterly updates to introduce you to new investments and to inform you of any other updates from the Capensis Capital business.

Investment Performance

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

You will be aware that your portfolio delivered a negative return in the first quarter of 2018. As I explained in the introductory letter I do not plan to comment on investment results until we send out the annual letter. Part of the reasoning is that the investment decisions are made based on long-term views which will not always translate into short-term gains. However, I would like to remind you of how the different fees are calculated just to avoid any confusion.

The performance fee levied on your account is calculated quarterly and subject to a 'high-water mark'. This means that the performance fee will only be charged in quarters where the cumulative growth generated by the portfolio exceeds the previous highest level (the previous high-water mark). Your portfolio will recover any declines before future performance fees are levied.

The on-going management fee is charged monthly with the aim of covering over-head costs. I hope to reduce the fee further once the business reaches a sustainable level.

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 individual securities. I do not specify a target cash level for any 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 being fully invested). Having cash adds resilience during market downturns and the ability to act quickly when opportunities arise.

2. Teekay Offshore (TOO)

The first of your new holdings is Teekay Offshore. This limited partnership is an operator of infrastructure assets required for deep-water offshore oil production. It operates a fleet of vessels involved in the storage, production and transport of oil as well as towing and maintenance services for the offshore oil industry.

TOO was previously financially mismanaged. It was controlled by a parent company, Teekay Corporation, but in September 2017 Brookfield Asset Management (one of your large portfolio holdings) bought effective control and recapitalised the partnership. This capital injection was necessary following years of a sole focus on the dividend, rather than the sustainability of the business. Additionally, TOO embarked on a capital expansion programme that unfortunately coincided with the implosion of the oil markets after 2014. The combination of which left the partnership with an inefficient, over-geared balance sheet.

I regard Brookfield's involvement as a disciplinary take-over. As part of the deal, the unsustainably high dividend was cut to the minimum level and Brookfield provided a large enough capital injection to fully fund the planned capital expansion. However, it also left TOO without a natural buyer for its shares in the market. Income investors were no longer interested and many institutions where worried about its previous flirtation with bankruptcy. This created your opportunity.

Brookfield has a successful track record as an owner-operator of infrastructure assets. They have strong incentives to focus on capital growth, rather than the previous regime of income distribution. Brookfield owns around 60% of the partnership units, but also options that are valuable only when the unit price reaches $4.00 (around 70% higher than current levels). Moreover, the entity through which Brookfield purchased the stake has a performance fee based on capital growth.

I expect the cash flow generated by the additional investments to begin to show this year and TOO should deliver significant levels of cash flow in coming years.

3. First Republic Bank (FRC)

The next new purchase is First Republic Bank. FRC is a bank and wealth management business focused on high net worth individuals. The bank was founded in 1985 by James Herbert who continues to serve as Chairman and CEO with a significant investment in the company's shares.

FRC runs a very focused business. It offers traditional banking services (loans and deposits) and wealth management. In fact, FRC is quite deliberate about the lines of business they choose to avoid. These include investment banking activities (proprietary trading, market making, derivatives etc) and high-risk transactions (sub-prime or foreign currency lending, trade finance etc).

The business has an impressive track record. Over the past five years it has grown deposits by 20% p.a., loans by 17% p.a. and assets under management by 28% p.a. It has remained consistently profitable since its founding and has shown exceptionally low losses from lending activities. Since 1985, it has cumulatively written off only 16bps (0.16%) on $205 billion of loans originated.

Geographically, 87% of the operations are in San Francisco, New York, Los Angeles and Boston. These are areas in the US that are growing faster than the country as a whole and while it contains only 21% of all US households, it accounts for 58% of high net worth households. FRC's market share of these households was only 4% in 2015 indicating potential for continued growth.

What is most impressive, however, is FRC's culture of exceptional service. Measured by net promotor scores, FRC is rated higher than businesses like Apple, Netflix, Amazon or even Ritz Carlton. FRC's client satisfaction measures at least twice as high as the banking industry. This also plays out in client retention rates (FRC sees only 2% annual attrition rates) and the majority of loan and deposit growth is from existing clients.

FRC is investing in expanding its reach and attracting new (younger) clients to deliver growth for the future. This includes student loan refinance options and a business that enables employers to contribute to the repayment of employee's debt. Early indications are encouraging in this regard.

CAPENSIS CAPITAL

Annual results

All of the companies in your portfolio reported annual results during the quarter. Below is a quick overview of the results of your largest holdings:

Berkshire Hathaway

Berkshire reported an increase of 23% in its per share book value during 2017. However, a significant portion of this increase was due to the changes to US tax laws enacted in December of last year. This once-off gain contributed 10% of the growth while the underlying operations delivered 13%. This is a strong result and is ahead of my long-term growth expectation for the business.

The company announced that Ajit Jain and Greg Abel will join the board of the company as Vice Chairmen with responsibility over insurance operations and other operations respectively. Together with previous years' appointments of Todd Combs, Ted Weschler and Tracy Britt Cool, the company is building out the succession plan post Buffett and Munger.

The company will again stream its annual meeting on 5 May 2018. You can access the video through this link: https://finance.yahoo.com/brklivestream. In preparation, please read the annual shareholders letter by CEO, Warren Buffett.

Brookfield Asset Management

Brookfield continued to increase its asset base at an impressive rate. Fee bearing capital increased by 15% to $126 billion leading to fee related earnings growth of 26% for the asset manager and significant growth in unrealised carried interest as the private funds continue to mature.

The overall thesis remains the same: Brookfield is very well positioned to be one of the largest beneficiaries of an increasing allocation of real assets by the large pools of capital. Sovereign wealth funds and pensions plans are unable to meet their required returns with the yields available on fixed income instruments. The return of volatility in the equity markets further increase these funds' appetite for alternatives which include real assets. Brookfield's expertise in investing and operating property, infrastructure and renewable energy assets (and more recently branching out into private equity) is highly valuable in these scenarios.

Read more in Bruce Flatt's letter to shareholders.

Exor

Exor reported 57% growth in USD net asset value per share in 2017. The strong growth was delivered by the three legs of the old Fiat stable:

- Fiat Chrysler Automobiles (FCA): +96%
- Ferrari: +81%
- CNH Industrial (CNHI): +54%

I find it difficult to conclude that Ferrari is obviously cheap at these levels. However, CNHI could benefit from a cyclical upswing and FCA offers value should management continue to deliver on their strategy.

Two large transactions involving reinsurance companies were announced during the quarter. AIG is purchasing Validus, while XL is selling to AIG. When I value Exor's Partner Re at a similar valuation to these private market transactions, it suggests that through Exor, you are holding the portfolio of listed businesses (FCA, Ferrari, CNHI and Juventus) at a 40% discount.

I encourage you to read the letter to shareholders by CEO John Elkann.

CAPENSIS CAPITAL

Howden Joinery

Howdens reported continued growth from the sales of kitchens in the UK. Revenues increased by 7% in total or 5% on a same store basis, largely attributable to volume growth. This is a positive result in a tough environment and ahead of its main competitors. I am particularly pleased that sales momentum seems to be increasing as the growth in the first periods of the new financial year was particularly strong.

The company managed to maintain profits in a year with a number of non-recurring expenses, and continues to generate high levels of cash flow. I estimate the current free cash flow yield around 6% could grow at double digit rates over the medium term.

The business is very well positioned for the future. It has no financial debt, organic growth opportunities and strong cash flows. Incoming CEO, Andrew Livingston, has a strong base to build from.

L Brands

L Brands returned to positive comparable sales growth following the decision to exit swimwear and apparel as mentioned in a previous letter. However, the company announced that they will invest the full benefit of the US tax reforms to increase wages at stores and guided to lower profit margins in the near term.

It seems that the recovery at Victoria Secret is progressing slower than I anticipated but growth at Bath & Body Works was strong.

I remain of the opinion that the business offers value to patient investors. The current share price does not imply any material improvement 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

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

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 31 March 2018.

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.