January 2018

Dear Investor,

2017 ANNUAL LETTER

This is my first annual letter to investors and it's my privilege to provide some early feedback on your investment with Capensis Capital.

I started managing individual accounts at the beginning of April 2017 and this letter covers the first three quarters of operation. In the time frame of our journey, this is a very short period of time. As I explained in my introductory letter, the business is on a multi-decade journey and, while the initial results are encouraging, bear in mind that your portfolio had the benefit of strong equity markets during 2017.

Investment Results

	Capensis Capital (Consolidated)	Benchmark (US Inflation + 6%)	Average Cash Holding
2017 (April – Dec)	11.0%	5.6%	64%

Source: *Interactive Brokers, Reuters, Capensis Capital.*

For the first nine months, the consolidated portfolio grew by **+11.2%** (after fees) which compares well to the benchmark of US inflation plus 6% at **+6.2%.** The average cash holding during the period was 64%. We ended the year with slightly over 50% in cash.

Please also review the investment statement that I'm sending with this letter. Your individual return might differ from the returns above, depending on your starting date and some minor differences in your portfolio compared to the consolidated account.

The Business of Capensis Capital

A total of 31 friends and family members opened accounts at Capensis Capital during 2017. Assets under management increased to $4.4 million.

Some of you might point out that this is above the initial target for breakeven discussed in my introductory letter and the level where I hoped to pause the signing-on of new clients. Unfortunately, like so many present-day state-owned enterprises, my budget for Capensis has seen some expense creep during the year. The additional expenses should ultimately be to your benefit: Capensis Capital is spending more on reading material, conferences, and compliance than initially budgeted. Additionally, the strengthening of the South African rand has meant that the US dollar fees you're paying translate into less overhead back in Cape Town. For full disclosure, I also upgraded my office space to around 10 square meters with a window. Feel free to visit me for a site inspection and coffee.

At present, I still aim to pause adding new investors when we reach a group of 50 investors, so long as the business is on a financially sustainable setting at the time. Please spread the word and direct any like-minded potential investors to my investor letters.

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Investment Review

During 2017, the portfolio had one holding that went through a full investment cycle. State National Companies is the only business that is no longer part of your portfolio.

1. ***State National Companies (SNC)***

Please refer to the 2017 Q2 and Q3 Letters for background information about SNC.

SNC was an interesting niche insurance opportunity but had significant client concentration. Two clients, Meadowbrook Insurance and Nephila Capital were responsible for more than 40% of the Insurance Fronting fees and as much as 30% of company pre-tax profits.

My analysis in March 2017 suggested that SNC could have an intrinsic value above $20 per share, so long as the business retained and attracted clients in the Fronting business. The business traded around $14 per share, which implied that the market expected SNC to lose at least one of the large accounts. It was my understanding that Meadowbrook would likely end its arrangement with SNC when its credit rating improved, but that Nephila offered very attractive long-term growth potential. This presented an attractive risk-reward balance: limited downside and significant upside if management delivered on their strategy. Your portfolio started with a 4% position in April 2017.

As the year progressed the share price increased. Part of the increase could be explained by the success SNC had in adding more large clients to the Fronting business and because Meadowbrook failed to achieve a ratings upgrade. Additionally, Meadowbrook's owners, Fosun International, received a lot of negative press regarding its financial situation. This was also confirmed by people who understand the Chinese market better than I do. The new information increased my estimate of fair value but the growth in the share price reduced the risk-reward balance in the opportunity. I held the position and allowed SNC's exposure to increase in the portfolios.

Moreover, there were persistent (but unverifiable) rumours that SNC was putting itself up for sale. In July, Markel made an offer to acquire SNC entirely and the share price quickly increased to Markel's $21 offer price. In reviewing the purchase details and the proxy statement, it became clear that the internal projections SNC provided to potential acquirers were significantly more optimistic than my estimates. However, without using these rosy internal projection, my estimate of fair value increased to around $25 per share and I concluded that Markel is probably making a good deal buying SNC at $21 per share.

As I discussed in the previous letter, I took advantage of some temporary weakness in the share price during September to increase your allocation in SNC to a full 10% of the portfolio. Your investment in SNC changed from a long-term position to a special situation. I sold your position in October when the market offered to buy SNC shares above Markel's offer price. SNC was ultimately acquired by Markel in November for the agreed upon $21 per share.

Your ownership of SNC was of a shorter duration than I planned for. Generally, I do not expect to trade in and out of businesses in such a fashion, but I trust that you appreciate the thinking behind these trades in your account. My aim remains to build a portfolio of businesses that will allow your capital to compound over many years. However, this is an example of where a special situation made it possible to extract additional return over the short term.

Credit goes to Peter Rabover who was the source of this interesting (and very profitable) idea and thank you also to two of my investors who helped me to understand the intricacies of SNC's lines of business in a short amount of time.

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.

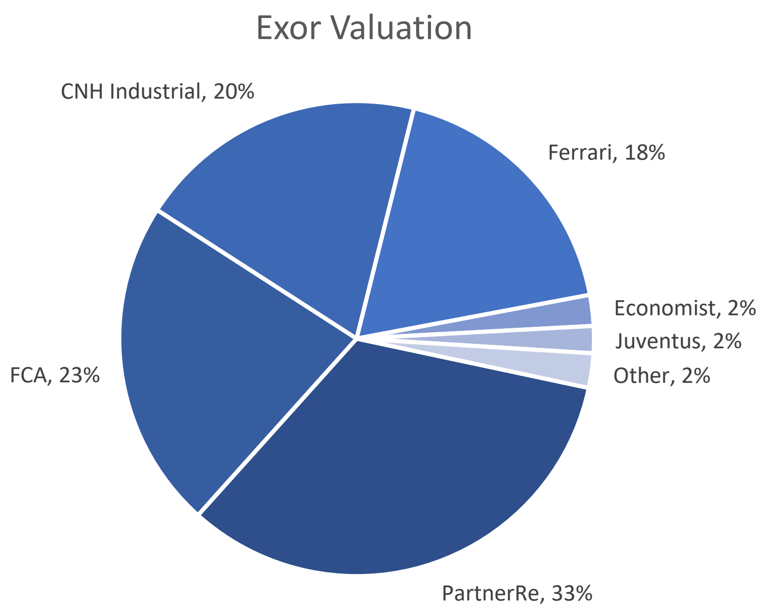
I expect the portfolio to have some cash available most of the time. The mandate, according to which I manage the accounts, is a flexible one. In other words, I am not bound to be fully invested. Consequently, I do not feel pressured to rush to invest all capital during periods in which the markets continue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

2. Exor

Exor is the largest new addition to the portfolio. It is a European investment holding company, which is controlled by the Agnelli family and traces its roots back to Giovanni Agnelli who co-founded Fiat in 1899.

The company consists of the following assets:

- PartnerRe – a global reinsurer headquartered in Bermuda, which was fully acquired by Exor in 2016.
- Fiat Chrysler Automobiles (FCA) – the seventh largest global automaker (listed in Italy and the US, 29.2% owned by Exor)
- CNH Industrial (CHNI) – a capital goods manufacturer (listed in Italy and the US, 26.9% owned by Exor)
- Ferrari – the sports car manufacturer (listed in Italy and the US, 22.9% owned by Exor)
- The Economist Group – publisher of The Economist newspaper (43.4% owned by Exor)
- Juventus football club – a premier Italian football club (listed in Italy, 63.8% owned by Exor)
- Cash and other investments



The business has a gross asset value of €22.1 billion and gross debt of €3.3 billion leading to a net valuation of €18.8 billion or €78.00 per share. The Exor share price closed the year at €51.10 which implies a 34% discount to the sum of the parts valuation and a margin of safety.

However, the compelling part of this investment is more than just an attractive price. In Exor, you are partnering with a competent and focused management team led by John Elkann and Sergio Marchionne.

John Elkann is the 41-year-old chairman of the controlling Agnelli family and has been CEO of Exor since 2011. Under his leadership, the business has simplified its structure and transformed from an Italian industrial conglomerate to a modern investment holding company. He has shown an impressive capital allocation ability and I hope for many years of his leadership at Exor.

Elkann is assisted by Sergio Marchionne, who has delivered extensive improvements at Fiat. Since he joined Fiat as CEO in 2004, he has executed many smart (and value-adding) deals. He merged Fiat with Chrysler to form FCA, joined Fiat Industrial with CNH Global to form CNHI and spun off Ferrari as a separate listing.

Marchionne announced an ambitious five-year plan for FCA in 2014 which aimed for increased production, higher profitability, and a lower debt level. As the years passed, the likelihood of FCA achieving these lofty goals increased and FCA turned into a stock market darling. There is a high probability of further corporate activity at FCA during 2018 leading up to Marchionne's retirement from FCA in 2019.

Exor has delivered returns significantly higher than the market since the global financial crisis and has the objective of continuing to outperform the MSCI World Index on a per share basis in USD. I recommend watching the 2017 Investor Day if you have a couple of hours to spare.

In Exor, you own a valuable portfolio of assets, which is curated by a skilful group of individuals and is trading at a significant discount to its underlying value.

3. *RIB Software (RIB)*

RIB is a construction software innovator specialising in 5D Business Information Modelling (5D BIM). 5D BIM refers to the linking of standard 3D modelling with two additional dimensions: cost and scheduling. It allows project managers to model a construction project with the additional information of changes in overall cost and progress over time.

The BIM market offers significant disruption opportunities. According to McKinsey, the construction market is one of the least digitised industries and large projects take 20% longer to complete and are up to 80% over budget. 5D BIM software aims to assist in the delivery of large project cheaper and on time.

Thomas Wolf is the CEO and owns nearly 19% of the business.

In 2016 RIB announced a new joint venture with Flex Ltd. called YTWO Formative. Flex is an expert in outsourced manufacturing and logistics and has 12 different business lines earning revenues above $1 billion.

The YTWO venture could potentially change the construction industry by combining RIB's 5D BIM software with Flex's manufacturing and logistics expertise to build a contracting platform. This platform will enable YTWO to earn a margin on all procurement done through the platform and promises to reduce the overall cost of construction without additional costs to the contractor. Essentially, it is hoping to affect the same improvements to construction that automobile manufacturing has seen since the 1980s.

YTWO is initially targeting affordable housing in China, Germany and the USA. The market opportunity is truly enormous. Five large contractors have signed up in the past quarter to test the product and if the venture can deliver on management's targets, the value to RIB could be more than 4 times its current market capitalisation.

However, the ultimate addressable market is much larger if other construction projects are added to the platform.

I don't know whether YTWO will be as successful as RIB and Flex expect it to be and it will take a few years to play out. The price at which your investment in the business was made attributed very little value to the potential in the venture, so success will add significant value. Essentially, you paid a fair price for the current RIB and received the potential YTWO upside for free.

4. Genworth Financial (GNW)

GNW used to be part of General Electric and was separately listed in 2004. It is an insurance company with two main lines of business: mortgage insurance (MI) and long-term care (LTC).

MI is a profitable business, delivering around two-thirds of the company profits. However, the company has gone through turbulent times, largely due to its LTC business. It has turned out that the company vastly under-priced its premiums for long-term care policies and had to repeatedly increase its reserves due to three main reasons:

1. People live longer than GNW initially expected and are generating more claims than expected
2. Old age care is becoming increasingly expensive and is not covered by programmes such as Medicare
3. Lastly, fewer people cancelled their policies as competitors exited the market and policyholders realised the value of the cover

In October 2016, GNW agreed to be acquired by China Oceanwide for $5.43 per share. The offer was approved by shareholders but the deal has not closed. The main stumbling block is the required approval from the Committee on Foreign Investment in the United States (CFIUS), which has not approved many deals under the current administration.

Historically, around 70% of these deals succeeded and I expect this deal to be closed in 2018. This would deliver more than 70% of upside from current levels. However, should the deal not go through, GNW might deliver even more value in the future. This future outcome is more uncertain and would depend on the ability of GNW to increase its premium rates, delever its balance sheet, and earn acceptable returns on investments. The market is clearly not convinced and is pricing GNW at around 4x earnings and below 15% of its GAAP net asset value.

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. I find a lot of value in discussions about your portfolio and it remains most important to tell me if there is anything you disagree with.

Your partner in long-term value,

Henno

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Disclaimer

This document is intended for the clients of Capensis Capital (Pty) Ltd. All data provided by Capensis Capital, unless otherwise stated, is current as at 31 December 2017.

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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.

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