



MILKWOOD CAPITAL

TO POTENTIAL PARTNERS IN THE MILKWOOD FUND

This letter is for friends and family who may have an interest in investing in The Milkwood Fund. This letter seeks to explain my approach to investing, expectations partners should have, my 4-year track record and share class investment alternatives¹.

In particular this letter is only intended for those who may wish to subscribe to Class A shares - the friends and family option.

THE ORIGIN OF MILKWOOD CAPITAL

The Milkwood Fund (a Cayman incorporated fund) is run by Milkwood Capital Limited, with me, Rhys Summerton as the authorized representative.

Before starting Milkwood Capital, I was a sell-side analyst providing advice to over 300 buy side analysts and fund managers (for further details about me, [click here](#)). As lovely as they are as people, I would not feel comfortable investing my own money into any of their funds, except two.² Mostly the funds' investment process is flawed - the incentive is to grow funds under management rather than capital. In other cases, the fund structure limits capital appreciation.

At the same time, I am passionate about investing. I have also had reasonable success in my own personal account for years. I have applied the principles of Buffett, Graham and Munger to find interesting investment opportunities globally. For example, in 2012, I owned a share of a chocolate factory in England, a bank in Nigeria and a newspaper in Australia. If that hasn't put you off, please read on.

¹ This letter should be read in conjunction with our PPM and does not seek to be a substitute for that document.

² One has now closed their fund and the other invests mainly in Emerging Markets. I am happy to provide their names to Partners in Milkwood Capital.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

A few people have encouraged me to pursue my passion on a full time basis. Finally in 2013 I had the opportunity to make this a reality. Hence, I have set up Milkwood Capital.

THE SCOPE OF MILKWOOD CAPITAL

The Milkwood Fund is a long term, value oriented, global investment company. My aim is to grow our capital by investing in opportunities offering the greatest risk-adjusted return.

At the foundation of Milkwood is a fund structure that seeks to maximize long-term capital growth. To do this, we have made short-term sacrifices by limiting the size of assets (US\$100m) and only accepting money from those who share a long-term value approach to investing. Therefore, it may not generate the biggest fees or make our advisors happy, but I hope the end result will more than offset the short-term hardship.

INVESTMENTS

Milkwood is made up of 3 types of investment:

1. Undervalued companies – The idea is to find companies that have the potential to at least double in value on a 3-year view. By looking for such opportunities it ensures "a margin of safety" is taken into account when we make an estimate of intrinsic value.
2. Work-outs – In the Buffett Partnership letter of 1957, Mr Buffett described work-outs as follows: "A work-out is an investment which is dependable on a specific corporate action for its profit rather than a general advance in the price of the stock as

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

in the case of undervalued situations. Work-outs come about through sales, mergers, liquidations, tender offers”.

Because of M&A and companies constantly needing to invest and divest - opportunities present themselves which allows for our capital to be applied to generate excess returns with minimal risk. These are generally shorter-term ideas as they "work-out" in a few months (or don't as we have recently discovered).

3. Activist investments – Deep value turnaround situations where we will take a strategic stake in companies and work with management to turn them around.

Milkwood is unconstrained by region, market, sector or size.

FUND SIZE

From day 1, the fund will start off with my personal money. This represents 84% of my liquid net worth (and I don't have much that's illiquid).

For those who want to co-invest with me (now don't let me down!), I have created a partnership structure to facilitate this.

It is my intention to always be the fund's largest investor. During the first 3 years, the minimum I will allow my personal holding in the fund to drop to is 20%. The maximum individual investment into the fund is US\$20m. Therefore, the fund cannot be larger than US\$100m, (excluding capital growth), at its maximum³. I would, in fact, like it to be smaller than this (and it is likely I will at least be successful in achieving this).

³ Subject to change after the fund's third anniversary

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

The reason behind this approach is to maximize our, (yours and mine), capital gains. This is completely at odds with the conventional "wisdom" supplied by bankers and advisors, who generate bigger fees with bigger funds under management. It is also very different to how most funds are run today, where the fund manager is very happy to sacrifice performance for increased funds under management, and of course receive a bigger pay check at the end of the year. Just think, a US\$1bn fund charging a 2% management fee will make US\$20m annually simply by leaving your money in the bank.

Keeping the fund small will allow us to maximize our capital growth. We are more nimble. Importantly, the pool of investment ideas is larger - and I want it to stay that way.

Being the largest investor in the fund results in further protection for fellow investors and is one of our key risk mitigation factors. To explain: If a fund manager doesn't have the majority of his wealth in his fund, the worst outcome of a bad investment decision is to lose his job. The best is a healthy reward for taking an outsized risk. Rather, as far as Milkwood Capital is concerned, the returns I generate, you generate (before costs and fees).

If some of this sounds familiar, it should. The Buffett Partnerships established in 1956 had a very similar structure. Why does this matter?

A study of Warren Buffett leads to the conclusion that having the right structure from the start has contributed over a third of his success. This means that instead of the Buffett Partners compounding their capital at 24% a year since 1956, they would have achieved about 14%. So "poor" Mrs Peterson who invested \$5000 in the original partnership 56 years ago would have been worth "just" US\$17.7m, instead of US\$416m thanks to the structure of the partnership.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

I want Milkwood to have every opportunity for similar success, measured by capital growth. Having the right partners and structure are two imperatives for success.

RISKS

Risk has nothing to do with movements in share prices, volatility or any commonly used quantitative measure. (If you are looking for a Sharpe ratio, read no further). Rather, we like to assess risk in two ways. Firstly, we assess the risk of permanent capital loss. Secondly, (and this one often goes unreported), we assess the risk that the investment fails to generate the required return needed to grow our capital at the required rate. It is a risk to have your capital tied up in an investment generating no or low returns.

However our aim is to generate returns that outperform the market over time.

WHAT ABOUT THE "BUS"?

I intend to run Milkwood Capital for as long as I am able to.

If I am incapacitated or hit by the proverbial bus, a fellow fund manager has kindly agreed to wind up the fund. This will be done in as short duration as possible, being cognizant of not impacting the value of your investment.

In time, Milkwood is likely to add additional professionals. When that happens, the fund will be wound up by the team, should the need arise.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

MISTAKES

Before we discuss track record, we will go through the mistakes I have made over the past 4 years. I study mistakes very carefully and strive as hard as possible to avoid them in future. I can assure you we will find new ones to study!

Mistake 1 - Buying into a recovery prematurely

Mistake 2 - Being misled by management

Mistake 3 - Selling too early.

Mistake 4 - Hubris. It happens when things go right for too long.

PARTNER EXPECTATIONS

Some investors have asked what potential returns we can expect. I have no idea, except to say I can guarantee you that the returns achieved in my personal capacity detailed in the track record below, will not be replicated in Milkwood Capital, even though I have done as much as possible to ensure my approach doesn't change.

We have outlined the make up of the fund, which should help investors understand that the fund will underperform overall markets in bullish times and hopefully prove more defensive when investors are bearish. But, no guarantees of that either. Once again, your returns will be my returns...

Fund performance is best judged over the long term, probably through a market cycle of over 5 years. Short-term share prices are a poor indicator of the value of the businesses we invest in. We don't try to time our investments. We are likely to buy into companies when they first represent good value, which may prove to be too early.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

Bruce Berkowitz of Fairholme Funds calls this "premature accumulation", I prefer "being early". In the short term we cannot control how cheap some shares will become. It is only in the long term that we are confident that value will emerge and that our capital will grow.

BUY ON ASSETS, SELL ON EARNINGS

Our favourite kind of investment is one which trades below its tangible value, and yet we can see a time when it may sell way above that, on an earnings multiple.

In addition, I would warn against looking at short-term performance as most of our investments are value orientated. "Value shares don't run, they hop". This means that share prices can do very little for long periods of time before value is discovered. When they do, the prices tend to "hop". This contrasts with "momentum" stocks, which tend to move in a smooth upward direction. Those we tend to avoid.

QUARTERLY REPORTING

As this is a partnership, we want investors in the fund to have some insight into the investments the fund makes. On a quarterly basis we will provide an update regarding the portfolio, profiling some of the investments. The fact that our partners understand what is in the fund will increase their staying power in difficult times, I hope.

In addition, I would be happy to discuss the investments in the fund, (as time allows), only **WITH PARTNERS**. It wouldn't make sense to share our best ideas with those who have not invested in Milkwood. In addition, I have attempted to keep the structure as simple as possible so that you can understand what is being offered, and I can dedicate the time and energy to focus on growing our capital, without the leg irons larger funds wear.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

TRACK RECORD

Milkwood Capital is a new fund but I have been investing for my own account for many years. These investments have been in the confines of working at a bank, where I was subject to trading regulations, (which are not overly onerous and generally make sense), and time constraints. These regulations prevented me from investing against analyst recommendations made by the bank (which could have been a great source of profit!)

Track records are important. Warren Buffett said at this year's Berkshire Hathaway AGM: "I have no use whatsoever for projections or forecasts. We never look at projections, but...we look very deeply at track records." In the case of Milkwood, the track record is especially important as I intend to maintain the approach used in managing my personal account for the fund. In fact, I feel the more closely I can replicate this approach, the more successful the fund will be.

PLEASE DO NOT EXPECT THESE RETURNS TO BE REPLICATED.

For the year ending December:

- 2009 - 91%

- 2010 - 44%

- 2011 - 24%

- 2012 - 98%

Compound Annualised Return - 58%⁴

The opportunities that were available in 2009 are certainly not available today. Even so, the benefit of having a global remit means we can turnover many stones to find a few gems.

⁴ Audited by KPMG

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

At risk of boring you, the real test is whether we can outperform the market on a 5-year term. If we do well in the first or second year that will not be any guarantee that we can do well over an extended period. The converse is also true.

CAPITAL ALLOCATION:

To generate returns irrespective of the market, the portfolio will be structured to have 60% of the fund in 10-12 investments, excluding cash. At times we could hold significant cash positions if we can't find anything attractive to invest in. Please be patient. You are not paying us when we hold cash.

Having a focused portfolio means that if our best ideas work, they will have a positive impact on the portfolio. But they have to work.

I have intentionally left a gap here before we discuss....fees.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

MANAGEMENT AND PERFORMANCE FEES

Our fee structure is designed to reward investors in the fund for outperformance.

There are 3 share classes:

Class A (the friends and family option)	No management fee and 10% of fund's performance after costs
Class B	No management fee and 25% of fund's performance after costs
Class C	2% management fee and 20% of fund's performance after costs

Clearly Class A is the most attraction option. It is intended for friends and ex-colleagues. For those who invest in Class A now, you can add to your investment enjoying exactly the same economics as you initial investment at any time over the next 3 years (no management fee and 10% performance fee). So if you want to get your toes wet first, without a complete soaking this is the option (minimum investment size is US\$100 000).

But there is a catch. Each share class has a limit of US\$33.3m of equity available. Once Class A is full, you will have to explore Class B and C should you wish to invest in Milkwood.

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com



MILKWOOD CAPITAL

CONCLUSION

This is a fairly lengthy letter. If you have read to the end, it is likely you are serious about having your money managed in a constructive and sensible albeit unorthodox approach.

If - after careful consideration of the risks - you share our long-term valuation-based approach and would like to invest in Milkwood, please contact me at rhys@milkwoodcap.com. I would be happy discuss the three share classes available, regulations and any other matters regarding the fund. If you are in London, I am happy to meet in person.

Best Wishes

Rhys Summerton
August 2013

5-7 High Street
Sunninghill
Ascot
Berkshire
United Kingdom
SL5 7RE

Email: rhys@milkwoodcap.com
Tel: +44 (207) 243 8816
www.milkwoodcap.com