MILKWOOD CAPITAL

17 October 2016

To our partners in the Milkwood Fund

The Milkwood Fund is up 19.5% to the end of the third quarter of 2016[1].

	YTD 2016 (to 30 Sep)	Since Inception[2]
The Milkwood Fund (A)	19.5%	27.0%
MSCI World (MXWD)	4.8%	10.9%
Peer Group Funds (avg)	4.1%	6.9%

Quarterly letters are to update you, our fellow investors, on 1) material changes to the portfolio and 2) brief updates on our largest investments. We will keep this short.

In the case of 1) I'm happy to report that virtually nothing has changed in the portfolio besides some minor pruning. This is not due to a lack of effort (exhibit A: my golf handicap remains 12). Rather, by benchmarking potential new investments to our existing portfolio creates a hurdle that is tough to jump over. In other words, we really like what is in the portfolio already.

1 Please refer to your relevant statements for performances by share class
2 Inception was 14/01/2014

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By year end, I would hope to tell you about two new investments which will likely be material. Talk about a tease.

Sector	**2nd Quarter 2016**
Financials	Barclays Citi
Insurance	Metlife
Logistics	Locamerica Menzies
Retail	Sainsbury Tesco
Media	Neopost

A brief word about our performance.
Our fund has continued to perform well throughout 2016. Even so, it is the long term that we are focused on, so any short term outperformance (or underperformance) is, really, quite unimportant.

If you are a non UK investor, you may want to skip this paragraph.

One of our investors suggested we highlight that our performance is in US dollars. This has perhaps become even more important recently with the US dollar index being strong while our exposure to GBP, in particular, is hurting our performance. Our peer group of funds (that we benchmark our performance to) often report in GBP. After all, they are based in the UK (as are we) and have some of their investments in the UK (as are ours). Take the outstanding Woodford Income Fund, for example, which has a cult-like following in the UK. And that status appears justified, at least when viewed in GBP. Since their inception in 2014 (as is ours), that fund has returned 30%...in GBP. This translates into -4% in USD. Why does this make a difference? Mostly due to fees. Fees are based on the performance of the funds' reporting currency. A weak currency boosts fees paid to the fund manager and hurts returns to investors.

Our portfolio is over 2/3rds exposed to UK listed companies. Menzies and Barclays being our top 2 holdings after all. Both these companies are beneficiaries of a weaker GBP. In the case of Menzies, more than half its earnings are in currencies other than the pound. For Barclays, I estimate it is about 30%. I do not feel that any of this potential uplift is reflected in the share prices. This will likely cause earnings to surprise positively, and result in a re-rating.

Below is a brief update on our largest investments in the fund.

Menzies

Count to 4 and Menzies latest acquisition – ASIG – would have refueled a jet either at a US military base or a commercial airline somewhere in the world.

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Count to 6 and Menzies Aviation would have turned around the baggage for American Airlines, IAG, Virgin, or one of its other airlines.

Menzies is pursuing the acquisition of ASIG the largest aeroplane refueler globally. We like the acquisition as it gives Menzies more scale, increased customer depth, broader representation in the United States and many other benefits. To pay for this acquisition, Menzies is required to pay US$200m, which is being done partly through the issue of new shares. As material shareholders in Menzies, we will continue to support this capital raising by applying for new shares.

Post the transaction being concluded Menzies will generate £0.56 earnings per share in 2017 (share price is currently GBP5.10), growth of 15% on 2016. We expect further growth in future which should deliver very attractive returns for the fund, from an attractively-priced asset.

Financials

Our investments in financials – the most unloved sector - have started to benefit from the expectation of higher interest rates.

Importantly, management at our investments companies are making the correct capital allocation decisions. For example, MetLife under the leadership of ex-regulator (who else do you want running your insurance business?) Steve Kandarian wrote in the 2011 annual report "*Metlife will not pursue growth for growth's sake*" *and would "exit businesses that cannot consistently clear their hurdle rate*s". In his

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2015 letter he followed this up by saying *"we recognize that MetLife can and must do more to improve returns for shareholders. That is why in 2015 we launched the next phase of our corporate strategy, called Accellerating Value. We chose that name deliberately to make clear to everyone at MetLife that our No 1 goal must be to improve shareholder returns*." MetLife is delivering on this promise by separating off the retail business and successfully targeting overly-punitive regulation.

Of course, valuation underpins all our investments (not subjective measures such as "quality" which is where fund managers tend to gravitate to when valuations aren't attractive.) All trade at discounts to tangible value of between 25-50%. With tangible values growing, they continue to be attractive investments despite some recent share price strength.

Conclusion

I repeat below reasons why I believe that Milkwood will provide at least satisfactory returns in future:

1. Milkwood is small, which provides us with *more* opportunities to invest in compared to larger funds. Large funds are generally motivated by asset gathering rather than asset management.
2. Our fees are low (very!). You receive the benefit.
3. We are passionate about investing. If I had a choice of what to do during the day, finding a great investment idea surpasses everything else I'd rather be doing (note – I said "during the day"!).

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4. Milkwood has a global remit. There should always be countries, regions and sectors that offer interesting ideas
5. We have a concentrated portfolio, ensuring investments are only made when conviction is strong.

Having said that, short term results are random. We remain focused on the long term.

Our search for attractive investments continues. Our pipeline of ideas is strong and our process is working and disciplined.

As always, please feel free to contact us should you wish to discuss our fund and its prospects. On this point, we are moving to new offices at 12 Park Street, Windsor, SL4 1LU. This is about 800m from our existing office and right next to Windsor Castle and the Long Walk. We look forward to hosting you there.

Cordially,

Rhys

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Terms of Business

- Treat investors as partners
- Your returns are my returns
- Maintain a lean cost structure
- Highlight and honestly analyse mistakes
- Conduct ourselves with integrity and fairness in all our dealings
- Follow our ideas and convictions even at the expense of short term pain

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