MILKWOOD CAPITAL

September 2015

To our partners in the Milkwood Fund

In August, the fund was down around 9.5% according to our estimates[1]. This leaves us up about (or "only") 2.7% for the year. This is disappointing on an absolute basis, but less so compared to our main comparison index, the MSCI MXWD (down 5%), and most other similarly managed funds.

At the end of June we reported to you that the fund had performed well, outperforming all the major indexes by a considerable margin – around 1000bps. I also indicated that our performance should not be surprising for a number of reasons, such as being small, concentrated, luck, etc. On a relative basis, our performance has remained positive.

Our usual preference to communicate with our partners is on a semi-annual basis, so accept my apologies for this interruption. After I have explained the reasons for the decline in NAV I will discuss why I believe this is an opportune time to add to our investments in the fund.

REASONS FOR AUGUST'S DECLINE

1. The MSCI World Free Float weighted index fell 7.1% in August. We consider this the best proxy for our universe.

[1] The usual disclaimer applies, the administrator's monthly statement should be out mid-month so don't shoot me if the number varies a bit from this.

2. Our largest investments reported results which were taken negatively by the market. I will discuss these below.
3. Our short positions are generally kept relatively small, and while helping a bit (see the table below), I made the error of reducing some of these positions early, in order use our capital to invest in our best long ideas. An error compounded.

In our June letter, I wrote that what most fund managers were looking for simply doesn't exist at a reasonable price as markets were stretched. We generally know if markets are cheap or expensive simply by the number of opportunities we find to invest in. When we are finding many, markets tend to be cheap. As we wrote in the June letter, we have had to look much harder to find them.

With the recent decline in markets, opportunities are becoming more apparent. However, we mostly end up getting back to buying more of what is already in our portfolio.

LARGEST CONTRIBUTORS TO AUGUST'S DECLINE

Below, we show the absolute change in share prices on the month in US$ terms and their contribution to the fund's August performance. Importantly, it is becoming a strong trend among our companies with share price weakness to see either share buy backs and/or for directors to increase their shareholding.

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Losers	Contribution	Absolute USD August % Change	Insider Buying / Share Repurchase
Menzies	-2.4%	-13.5%	✓
Locamerica	-1.1%	-13.7%	✓
Neopost	-0.5%	-9.5%	
UIHC	-0.6%	-17.9%	✓
Tesco	-0.5%	-13.3%	
Sainsbury	-0.5%	-9.7%	✓
Metlife	-0.5%	-9.5%	✓
Sberbank	-0.5%	-12.3%	
Gainers			
Marfrig	1.3%	12.8%	✓
Asos (short)	0.2%	-13.2%	
Mr Price (short)	0.2%	-7.9%	
Cardtronics	0.1%	-6.9%	

MENZIES

We met Menzies management at the end of August following the release of their half-year results. Post the meeting and share price decline, we felt even more comfortable that the business is grossly undervalued. The distribution business, which the market is generally cautious about, is doing exactly what we would want. It is consolidating the northern UK market. The value placed on this business by most analysts is 4x earnings - while we think it is worth at least 8-10x.

The aviation business will continue to recover from the issues developed in 2014: Heathrow T5, staff shortages etc. This all leaves us feeling that the second half will be very positive and the full year results will be ahead of the planned turnaround.

Importantly, the revitalization of the distribution business continues to make our ultimate dream of company separation more of a reality. Menzies is comfortably worth double the current share price of GBP4.30. Management seem to agree with this – the CEO, CFO and another Director have all bought stock subsequent to the results being released.

So what explains the weak share price? Menzies is not a large company with a market cap of only GBP240m. One particularly large seller of the stock exists at the moment. We are familiar with them and know that they are selling for reasons completely unrelated to the underlying business. We are using this as an opportunity to increase our investment. If only we had more money…

LOCAMERICA

Locamerica also released strong results in August, but could not escape the pressure from a fund being forced to sell after it suffered from redemptions and margin calls. Brazil is currently a hotbed for all kinds of indiscriminate selling.

Results were strong in spite of an economy which is very tough. In earlier letters we made the case for the company to grow at the expense of weaker competitors in a high rates environment, and this has so far played out. Revenues were up 18% and EBITDA margins expanded 480bps y-o-y. So Locamerica is trading on a 6 P/E, with a tangible –and increasing - asset base worth nearly double its market value. We say increasing because its tangible value is made up of vehicles, which appreciate in Brazilian Real as the currency depreciates. This creates a real profit for Locamerica when they sell these vehicles.

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UIHC

The biggest faller in our portfolio was UIHC. We wrote about UIHC in the June letter, when the investment was still small in our portfolio. We have now doubled our position. Management have personally bought US$3m of stock in UIHC (in the open market) over the past 6 months. They did this at an average price of US$16.77. With UIHC trading at US$12.91, we feel as stupid as management does.

SBERBANK AND MAIL.RU

Both our Russian investments sold off during August due to lower oil, and the decline in emerging markets. Operationally, however, both were stars.

Sber reported better than expected results with net interest income up 13% q-o-q, and fee income up 20% y-o-y.

Sber is now trading on a 0.6x Price to Tangible NAV and 5x FY16 earnings. Wow!

Mail.ru also reported excellent results and revised guidance higher.

CONCLUSION

Short-term share price moves are anyone's guess. We don't know what will happen on a month-to-month basis. Volatility means zero in terms of risk. Rather, volatility provides opportunities. So please don't be too disappointed with August's performance.

I also can't promise that the portfolio will recover quickly from this pull back. All I can do is assure you that the portfolio is greatly undervalued and the results of our investments that have recently been reported confirm this view. I

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continue to find great investment ideas which I believe, over time, will result in superior performance both in relative and absolute terms. Most of these ideas are already in our portfolio.

I would encourage you to consider increasing your investment in the fund at a very depressed level, as both Andre and I have done. Alternatively, take our best ideas and buy them directly.

I welcome any feedback from our partners. Please feel free to call or visit us in Windsor.

Cordially,

Rhys Summerton

Please turn over

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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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