

October 2018

Dear Investor,

THIRD QUARTER OF 2018

My primary communication with you is the annual letter, but 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.

Markets

As I am writing this letter, markets globally are going through a difficult period. I have explained before that I see little value in commenting on the markets generally, but I have three ideas I would like to leave you with.

The first is that asset prices can go down. I do not mean to trivialise the matter, but markets have been through difficult periods in the past and will likely do so again in the future. It is important to remember that market declines are a natural part of investing. Your portfolio is managed according to an investment process that works over longer periods, but it is not immune to general market moves.

The second is that this process allows the portfolio to increase its allocation to businesses as they get cheaper. It will always be painful to see the value of a position decline, but I am prepared to increase exposure to businesses where the market offers more attractive prices. This will be done after reviewing the investment case and any new information.

Lastly, there are basically three types of competitive advantages available when managing portfolios: informational, analytical and behavioural. Informational advantages are seldom legal; I do not have any inside information on any of the companies you own. In some situations, I might have an analytical advantage, but this is limited for a team of one. The main advantage I am cultivating is behavioural:

- The ability to invest freely in businesses that might be different when compared to the indices
- The ability to hold cash and not be forced to be fully invested all the time
- The ability to invest with a long investment horizon
- The ability to be patient or aggressive depending on the opportunity set in the markets

Of course, none of this guarantees a successful outcome and I won't operate without mistakes, but I am thankful that you are giving me a fighting chance to deliver on my dream.

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 would like to discuss your portfolio, or if you have comments on anything in this letter.

Portfolio Updates

1. Cash

Your cash position remains the largest holding in the portfolio. As previously explained, holding cash is my default position and the size of the allocation is determined by the investment opportunities that I have found. Your cash position will fluctuate with the purchase and sale of individual securities and not because of any specific target level for cash in the 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. *Lam Research (Lam)*

A new position in the portfolio is Lam Research. Lam is a semiconductor capital equipment manufacturer. It supplies some of the tools that semiconductor manufacturers (companies like Samsung and Intel) require to produce memory and microchips.

These tools are used to selectively add or remove elements on a piece of silicone to build the components that ultimately form integrated circuits. This is a complex process that involves hundreds of steps of cleaning, depositing and etching of extremely thin layers of material, sometimes on an atomic level.

Follow [this link](#) for a quick introduction to the process.

As the name “microchip” implies, these components are very small. More than a billion components might be packed into an area of silicone smaller than a finger nail. Lam is one of small number of companies that specialise in this field of high precision operation.

Semiconductors are everywhere. It is in every piece of electronics you own. Anything that uses radio waves or is computerised depends on semiconductors to enable operation. Historically, the market cycles were heavily dependent on the PC refresh cycle. More recently, growth in the industry is being driven by mobile phones, data centres and the cloud as well as the proliferation of devices that is collectively referred to as the internet of things.

This growth is leading to a data economy in which data is being generated, transmitted, stored and processed on an incredible scale. Lam is one of the companies fundamentally involved in enabling this growth. However, this remains a cyclical industry and the uncertain near-term outlook for the industry is creating an opportunity to invest in this secular growth trend.

Lam will be a very successful investment if we see the promised value from artificial intelligence, autonomous driving, advanced medicine, smart infrastructure or any other scientific advancement that unlocks the value of big data.

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

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 30 September 2018.

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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.