URI | Capital Partners

“Seeking Understanding Through the Noise”

For the full year 2017 URI Capital Partners returned 22.85% after all fees and expenses compared to a total return including dividends of 21.8% for the S&P 500. That brings the fund’s cumulative return to 134.16% after all fees and expenses since its opening 5.4 years ago in early August 2012 (17.07% annualized). While those may be considered good results, recognize that we are investing for the long term and we will judge ourselves over much longer periods of time. I remain optimistic about our long term performance but cannot and will not attempt to prognosticate how we will perform in the short term.

(Note: as those invested in J19 Capital Partners already know, this fund focused on a concentrated selection of TARP warrants returned 31.59% after all fees in 2017).

It is late November and I am reading as I come across two incredible statistics:

(1) bitcoin is up ***896%*** since the start of the year (which rose to up 1,560% in the first full week of December…now, even later in December bitcoin is up 1,800%). And here is a story that you just can’t make up: CryptoKitties is an online game that allows players to bid for computer-generated images of cats. Bids are made using ethereum, a virtual currency similar to bitcoin. The game has gone viral and the highest bid so far for one of the computer generated images of a cat went for $100,000 in ethereum. Your eyes do not deceive: someone bid $100,000 for a computer image of a cat. The high bidder might argue that is great value by comparison to the $450 million (yes, nearly half a billion dollars) for a da Vinci painting this past year.

One more for good measure: a company called block.one raised $700 million at a $4.5 billion valuation. In the offering documents, the company describes what it is selling, tokens called EOS, as having “no purpose.” Additionally, the purchase agreement signed by investors states the tokens “do not have any rights, uses, purposes, attributes, functionalities or features.” You cannot make this up….

(2) Towards the more mundane, since January, growth stocks have outperformed value stocks by ***19%***, the most in such a short period aside from the last year of the dot-com bubble.

Put another way, it is comparatively tough sledding for those with feet firmly planted on the ground. So where do we plant our feet? What supports the foundation of our investing?

We strive to (and do) own a concentrated collection of enduring business that stand the test of time, generate significantly positive cash flow and are of good value, in a world where value is incredibly hard to find. We also realize, in our own lives, that placing too much importance on a financial ledger creates the seeds of its own destruction as the self-deification of financial success can lead to ruin. It can be important, but it should not be over prioritized.

Timeless and Innovative

While growth and innovation are exciting, it is possible, arguably glorious, to be both timeless and innovative, meeting the needs of yesterday, today and tomorrow.

Banking is an enduring business that has created and brought to scale great innovation. To that end, JP Morgan spends roughly $9 billion a year on technology. Now, much of that is not seen by the general public and simply serves to more efficiently manage the business. But much is also front and center to us. We can deposit checks by taking a picture. We can send payments, securely, to friends and family with a few simple clicks on our phone. JP Morgan is investing heavily behind blockchain technology, which may bring tremendous transactional efficiencies to the consumer and corporate sides of the business. In short, their business is both timeless and innovative, as are our other core holdings. Please see the Summer Partnership Update in Appendix A for summary thoughts on our top holdings.

(Consumer interest notes: if you send payments to others outside of the rails of a bank's payment system and money is lost or disputed, no one will stand in your corner. To facilitate *secure* person to person payments, most of the banks across the country developed a system called Zelle which allows person to person payments *secured and backed* by your bank. Also beware of providing your bank login information to third party websites and providers. If you provide login information to others, you have stepped outside the protective umbrella of the bank if money is lost or stolen. Caveat emptor.)

We started only one new, and still small, holding for the year: Barclays, a London-headquartered bank that was *first established in 1690*. Please see our report titled "Barclays – the Old, Old Thing" in Appendix B of this letter.

Widen the Lens But Narrow the Focus, and Deepen the Learning

In Michael Lewis' book "The Undoing Project," he writes, based on the extensive research done by the two behavioral economists Daniel Kahneman and Amos Tversky, that we draw too big of conclusions from too little information. People often ask or wonder why it takes me years to get comfortable before investing in a particular company. The pithy answer is that, in the end, the tortoise beats the hare. This also has the benefit of describing in fable terms our investing philosophy; slow and steady wins the race. But a more complete answer to the why of our seemingly extreme patience lies in our desire for deep learning that can lead to deep understanding. It takes *a long time* to find this deeper understanding that allows for the conviction we crave.

I share the below five bullets in nearly everything I write or present about the partnership. These are not sound bites. They are guiding principles in how we approach investing well.

- ***Perspective*** that moves past the noise of the day
- ***Patience*** to think and invest with a long term horizon
- ***Temperament*** to withstand emotions and volatility
- ***Passion*** for deep intensive research
- ***Conviction*** to our best ideas

We seek to move from a collection of facts, knowledge you might say, to understanding and, someday, to wisdom. And it takes Perspective (widening the lens of your perspective to move past the noise of the day), Patience (allowing accumulated thinking over long periods of time), Temperament (moving beyond the emotional ups and downs of a 24/7 news and information cycle), and Passion (having the passion to narrow the focus of our studies so we can go topically deep and wide) to deepen our learning and move down the spectrum of knowing to understanding. And with this deeper understanding we can carry Conviction to our best ideas.

Our long term perspective is a critical differentiator in our thinking and our investing. And I am grateful for you, my partners, in bringing a mindset that allows for such differentiating advantages. Most trading volume has a horizon of minutes, seconds and even milliseconds. Even the most long term minded investors tend think in years. We think and invest for decades, and longer. Thank you for partnering with the tortoise.

As an aside, my son got a tortoise for his birthday last summer. Beyond my concerns about a lifespan that should far exceed Tyler's time in our home (anyone want a tortoise in about a dozen years???), I was amazed at the *surprising speed* at which "Shelton" moves when free to do so………

The dangers of scratching the surface are often made apparent in headlines. Headlines are meant to grab our attention; they are not meant to inform. Let me provide just one example from the preeminent Wall Street Journal.

Headline: "Household Debt Hits a New High" – Wall Street Journal, Wednesday, November 15, 2017

Article Excerpt: The Federal Reserve Bank of New York said Tuesday that household debt totaled $12.955 trillion last quarter, up 0.9% from the spring for a 13th straight quarterly increase. That was the most on record, though the figure wasn't adjusted for inflation of population growth. As a share of U.S. economic output, household debt was about 66% last quarter versus a high around 87% in 2009.

The headline was entirely accurate, if incomplete. So, is household debt higher or lower than in 2009? Is the headline or the article correct? The answer, of course, is, "yes". They both contain accurate statements, or facts. Facts though are not understanding.

The Wall Street Journal is one of the most appropriately well respected newspapers in the world. This is not to degrade the WSJ. Consider the headline click baits elsewhere and how they have impacted our understanding. But, as you will see, even the articles can provide incomplete understanding:

There have been repeated instances of the following portrayal, often in my beloved and appropriately well respected Wall Street Journal: in writing about the newer, online-focused banks, the rate paid on online deposits often comes up as a point of discussion. In one article about Goldman Sachs' new online bank offering, it was stated that Goldman Sachs *can* pay more on these deposits because they lack the cost of a traditional bank infrastructure. While that sounds well and good, it is patently absurd. Goldman Sachs does not purposely overpay any more than a grocer pays higher prices for the food they sell because they might make too much money. They pay more for deposits because they *must* in order to grow and retain them. A higher rate paid on deposits is a sign of relative weakness, not strength. And, ever so importantly, lower rates paid on deposit are a sign of relative franchise strength.

GK Chesterton in “St. Thomas Aquinas” said the following:

> *“In so far as there was ever a bad break in philosophical history, it was not before St. Thomas, or at the beginning of medieval history; it was after St. Thomas and at the beginning of modern history. The great intellectual tradition that comes down to us from Pythagoras and Plato was never interrupted or lost through such trifles as the sack of Rome, the triumph of Attila or all the barbarian invasions of the Dark Ages. It was only lost after the introduction of printing, the discovery of America,, the founding of the Royal Society and all the enlightenment of the Renaissance and the modern world. It was there, if anywhere, that there was lost or impatiently snapped the long thin delicate thread that had descended from distant antiquity, the thread of that unusual human hobby, the habit of thinking.”*

Let us not fall into the same loss of habit. Reading can and will bring you facts and knowledge. And fewer things are more powerful than voracious reading. But it is incumbent upon us to turn those facts into understanding and, someday, to turn that understanding into wisdom. Read and learn deeply. Seek understanding and wisdom.

Ok, I wanted to be done with this section of the letter but this morning (early December) I am reviewing news on our holdings and saw the following headline: “Big U.S. Banks as Risky Today as 2007”. I truly don’t even know where to begin on this one, but let me start with this: the last section of the article was entitled The Final Word and contains this: “The system (the banking and financial system) is far more resilient than it was when the financial crisis loomed a decade ago….” Yep, that sentence is from the same article as the incendiary headline.

This is not to say new risks in the financial system have not emerged (the referenced report appropriately discusses new risks such as cyber along with longstanding risks that still remain, such as derivatives). These risks require vigilance. BUT, that is far different than what the headline infers.

And, here’s the kicker: They succeeded. I clicked to their article. They won.

Here are Chair Yellen’s words on the matter in her last press conference as Chairwoman of the Fed: When asked about the health of the banking system relative to before the crisis, she said, “The banking system is far more resilient and stronger…”

I have written extensively on this subject and I have included excerpts from prior writings in Appendix C to this letter.

Hunting for Puzzle Pieces of Long Term Tailwinds and Headwinds

“The Trouble with Prosperity,” written by James Grant in 1996, describes the dynamic that when something lasts long enough, a belief grows that it cannot change. Decisions are made predicated on this increasingly believed sense of permanence. A direct quote from the book: “the more long-lived the investment trend, the more likely it appears to be permanent.”

The challenge of course comes when change returns and the assumed permanence ceases to be permanent.

Rates have been low, seemingly forever. And it sure seems they will stay low, seemingly forever. But consider a longer view of rates: Post WWII, long rates were near 2% and ultimately moved towards 15% by the early 1980s before coming back down to the 2% levels of today.

For many businesses, the long, consistent decline in interest rates from the early 1980s to today have been an undeniable tailwind to their cash generation capabilities and valuations. Beyond the simplistic understanding that lower interest rates bring lower interest expense and thus higher net income and cash flow, declining and lower interest rates have provided a tailwind to capital investment. And, in addition to the lower cost, the abundant availability of this lower cost financing has provided a separate but additive tailwind. Consider a capital intensive business that uses leverage as a part of its investment and capital allocation plans. For the last 35 plus years, their financing costs have come down and their profits and cash flow have experienced a meaningful long term tailwind.

How likely is this to continue? At a minimum, the tailwind is likely to become no wind (with rates staying at these low levels forever). But, it is certainly within the realm of possibility that the 35 plus years of financing cost tailwind turns into some degree of a headwind. With that as a real possibility given our long dated investment horizon, we are particularly wary of making either explicit, or implicit, bets on rates staying low forever.

The explicit case is most clear: Investing at low, fixed rates for long periods of time brings to mind the ironical moniker of return-free risk. Long dated bond buyers are carrying significant risk while earning precious little return.

The implicit case is a little harder to see: Consider a levered cable company. Returns on the business are pretty good with a largely recurring base of revenue. Household formation is a tailwind. Because of these and many other factors, there has been significant wealth creation in the industry. And, particularly for the more levered players, lower and lower financing costs along with abundant capital availability have allowed for greater levels of investments at higher returns on equity. But, how much of all that value creation was intrinsic to the business itself and how much should be attributed to 35 years of abundant and increasingly lower cost financing? I would posit that is not an easy question to answer. But, in assessing what value can be created going forward, one should allow for the assumption of at least no financing winds, and possibly slight headwinds. Does that make the levered cable company a bad investment? Not necessarily as the cost and availability of financing is one of many factors that will determine long term value creation. But I believe this one example of a long term tailwind that has the potential to peter out and is more prevalent in the investing landscape than commonly discussed.

The other dynamic associated with interest rates is their gravitational pull on company and asset valuations. Lower rates bring higher valuations. But, the reverse is also true. Higher rates should bring lower valuations, all else equal. And, companies and assets higher valuations carry more of this risk than those more modestly valued.

<u>Why URI Capital Partners?</u>

I want to close with this section again this year to help ensure we do not lose sight of our longer term aspirations.

While our business is that of investing, the purpose behind the effort is to bring future goals, dreams and ambitions into the realm of attainable. Many of our goals, dreams and ambitions require time and resources (money). And, for better or worse, time and money are inextricably linked. We first need the freedom (the time) and then we need the resources to accomplish our dreams.

The above could be thought of as the "why" for investing generally but I want to take one further step for the "why" of URI Capital Partners: We aim to provide above average long term returns because, particularly over longer periods of time, a little outperformance goes a long, long way. It is possible I will end up having run a treadmill where I work strenuously only to equal the results of the broader market and other investors. While not at all damaging, it would at a minimum be tiring (for me at least).

Consider the chart below representing the end results of a $1 million invested over varying periods of time and return levels. The market has averaged (not in a straight line for sure) about 8% over long periods of time (given lower rates and full to fair broader market valuations a more reasonable expectation might be a range of 5% to 8%). This 8% brings very attractive results for those with the patience and persistence to stay for the long haul. But this chart also shows the dramatic effects that outperformance can have for investors and that remains the second "why" of URI Capital Partners. We hope to do a little better over the long term and make each of your goals and ambitions a little larger.

	Annualized Returns			
Years	4.0%	8.0%	12.0%	16.0%
10	$1,480,244	$2,158,925	$3,105,848	$4,411,435
20	$2,191,123	$4,660,957	$9,646,293	$19,460,759
30	$3,243,398	$10,062,657	$29,959,922	$85,849,877

Many of you have asked what is my "why" for stewarding URI Capital Partners? Let me offer two reasons: (1) URI Capital Partners matters to me financially and (2) I enjoy the long run competitive game of investing well. I am blessed to follow a passion and serve others along the way.

Finally, and most importantly, thank you all for your belief in what we are working to accomplish. I take the responsibility of stewarding your investment very seriously. To paraphrase from the Book of Luke 12:48: "To Whom Much is Given, Much Is Expected". That should hold true for all of us both personally and professionally and it certainly does for me.

Our perspective is long and enduring. And our future is bright.

Warmest Regards,
Brian Pitkin
URI Capital Management, LLC

URI | Capital Management

Important Disclaimers:

The performance listed above is being provided to you for informational and discussion purposes only. Actual returns are specific to each investor.

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In considering any performance data contained in this report, you should bear in mind that past or targeted performance is not indicative of future results and there can be no assurance that the fund will not sustain material losses. Nothing in this report should be deemed to be a prediction or projection of future performance.

URI | Capital Partners

"Seeking Understanding Through the Noise"

APPENDIX A

State of the Partnership - Summer 2017

Partners:

I am often asked what I think of the "market" and whether it will go up or down over some period of time. I imagine the increasing frequency of these questions arise from the "market" hitting new highs in recent weeks and months. As most of you know, I do not pretend to know what the market will do over short to medium periods of time. I do however have very strong opinions about our holdings, their longer term prognosis and what that can mean for our longer term returns. With that in mind, I thought it would be helpful to provide a "State of the Partnership" for the summer of 2017.

To begin, the market as defined by the S&P 500 trades at a price to book value of 3.1x. Considering S&P earnings, valuations range from 24x prior year earnings to roughly 18x earnings for the next twelve months. Looking a little further out in time, the S&P 500 trades around 17x 2018 estimated earnings. Recognizing the inherent variability and imperfections in how operating (normalized for unusual items) earnings are calculated (everyone has a different estimate), these valuations are probably described as full but not egregious, particularly given the low level of interest rates.

Speaking of interest rates, they stand at historically low levels. Post WWII, long rates were near 2% and ultimately moved towards 15% by the early 1980s before coming back down to the 2% levels of today. Investing at such low, fixed rates for long periods of time brings to mind the ironical moniker of return-free risk. Long dated bond buyers are carrying significant risk while earning precious little return.

But where do we as URI Capital stand?

To begin, we own better than average companies with strong management, rock solid balance sheets, significant earnings and cash generation and businesses that stand to be better tomorrow than they are today.

Our top four holdings dominate the partnership today comprising roughly 80% of the total fund so it is particularly instructive to focus on the valuation and prognosis of these four holdings. *On weighted average basis, they trade at a price to book value of 1.15x, with the two of the four still trading below book value.* They are each highly profitable and, on a weighted basis, trade below 12.5x earnings over the next twelve months and roughly 11x 2018 estimated earnings. My own assessment of their medium term earnings power implies they trade below 10x my estimate of their earnings power. It quickly and strikingly becomes obvious that these measures of value for our core holdings stand in stark contrast to the market at large. More importantly, the intrinsic value for each of the companies is well in excess of where they trade today.

A short summary of the value proposition for each of these four holdings follow but I also have much more extensive reports on each (and others) and would be happy to share and discuss them with you at your convenience.

The path forward to me is clear. Investing is putting aside dollars today to bring more rewards in the future. For my money and yours, I believe we are positioned to do just that. And we are better positioned than our available alternatives. The best time to invest is often when it feels the least comfortable. Whether with your existing dollars in the fund or any prospective new investment dollars, we are a strong foundation for your future plans. I have voted with my own money and that of my family and will continue doing so.

All the best,
Brian

<u>JP Morgan (including warrants) and Bank of America</u>

For summary purposes we can link JP Morgan and Bank of America together as many of the underlying dynamics are similar between the two companies. Our discussion will begin with the balance sheet but let's first take a step back and consider the recent financial crisis which still lurks in the minds of investors. Going into the crisis, banks were operating with thin equity cushions, very little liquidity and large amounts of short term wholesale funding. Even minor hiccups could have caused a funding crisis. And that is exactly what happened. The larger and more sustained problems of the crisis created massive short term funding problems which ultimately brought down many of our largest financial institutions. Many financial institutions required new overnight funding each and every new day. *There was no margin for error.* These crisis memories loom large and create a sense of the large banks being uninvestable for many.

How times have changed. Big bank balance sheets are nearly indestructible today. Capital and liquidity are at levels never seen before. Capital levels are well more than double what they were pre crisis and system wide are higher than they have been since the 1930s with the largest banks carrying higher equity than any others. There is essentially no overnight wholesale funding that tipped many institutions over the edge. And the change in liquidity is even more pronounced. The amount of High Quality Liquid Assets (can be thought of as readily available cash and cash equivalents) on bank balance sheets has skyrocketed. Both JP Morgan and Bank of America each have *more than $500 billion* of these readily liquid assets comprising more than 20% of their total assets and triple their levels of tangible equity. As one example, *Bank of America's time to required funding exceeds 36 months* where for many before the crisis the time to required funding was essentially one day (because of overnight funding requirements). The foundation on which to invest in these banks is incredibly strong and durable.

While standing on a strong foundation, these two banks are generating record and significant earnings. Importantly, they are poised to generate much higher earnings in the future. Without any change in the overall environment, their continued expense reductions plans alone will drive higher earnings. (Bank of America has reduced operating expenses from roughly $70 billion to a near term target of $53 billion for the full year 2018.) Any greater normalization of the banking, rate and revenue environment will bring yet higher earnings and returns as these banks have become coiled springs of profitability substantially slimming down through recent trying times.

Most importantly and in contrast to most of the market today, these two banks trade at historically low valuation levels. Bank of America still trades below book value and JP Morgan trades at only a modest premium to book value. It is important to note that each have consistently grown book value per share in recent years in what has been a most challenged time for the industry. Relative to earnings, they each trade around 10x estimated 2018 earnings and below 10x my estimate or their medium term normalized earnings power.

Banking is an enduring business that has stood the test of time. JP Morgan and Bank of America have substantial levels of both capital and liquidity providing great durability to their businesses. They each have the scale, reach, diversity and deposit franchises to thrive over the long term. Their businesses have been greatly simplified and they have posted surprisingly stable and resilient underlying earnings and returns even against historically large headwinds. Importantly, they have much more earnings power in front of them than behind them and they trade at historically attractive valuations allowing for strong returns for those with a longer term perspective.

Berkshire Hathaway

Berkshire Hathaway is a collection of great businesses held both as controlled operating businesses and as investments in publicly traded companies built on a foundation of world class and profitable insurance businesses. When considering Berkshire Hathaway many focus on the man of Buffett, but it is the surprisingly underappreciated power of the Berkshire model that has made its outsized returns possible. More importantly for today, it is the power of the Berkshire model that will persist into the future even when Buffett is no longer leading the company. The real genius of Buffett has been in the construction of a business model that is an unstoppable compounding machine. There are four key aspects to the model: (1) the power of float, (2) the power of flexibility, (3) the power of internal cash generation and (4) the power of deferral. (There is more detail on each of these powerful structural advantages in our more involved report on Berkshire.)

Berkshire carries a reputation for honest, reliably consistent and shareholder focused actions. The Company has the broadest of mandates, which allows the flexibility to invest wherever the best returns exist, irrespective of industry or asset class. This perpetual and tax efficient investment flexibility along with the consistent stream of new cash from both internal cash generation and float from the insurance businesses nearly guarantees reliable increases in intrinsic value over time. Most importantly, Berkshire remains available for investment today at attractive valuations.

The combined cash flow from controlled businesses and insurance operations and the income from investments can be thought of as a water hose that continues to pour water/new capital into Berkshire building larger and larger buckets of value by adding new controlled businesses and new investments through time. Cash cannot help but build inside Berkshire and that cash is an immediate add to value before even accounting for how the newly created cash is ultimately invested. Additionally, the underlying earnings power of the myriad of businesses already under the Berkshire umbrella will continue to increase value above and beyond cash generation. Studying the past helps put perspective on the company’s ability to sustainably and durably add value. Since 1970, Berkshire’s per share investments have grown at 19% compounded annually, while the per share amount of non-insurance operating earnings has compounded at a 20.6% clip. While not expecting this amount of growth in the coming years, it would be foolish to believe Berkshire’s ability to grow has reached a ceiling.

Our current estimate of Berkshire's intrinsic value of roughly $300,000 per share allows for investment near today's price of $255,000 with a margin of safety and strong risk-adjusted prospective returns. Additionally, value will continue to accrete through the power of Berkshire's business model. We can expect intrinsic value to grow at roughly 10% for the foreseeable future further augmenting our returns.

<u>AIG (including warrants)</u>

There are times when valuation work can be overly complicated. But if you need a highly complex spreadsheet to figure out if a company is undervalued, you already know the answer. Value should hit you in the face. With AIG today, we are paying below 80% of book value for a profitable insurer that operates at scale around the world with deep levels of both capital and liquidity. Combining normalized returns well above current levels with a return to more normalized valuations yields outsized return potential in the coming years.

The balance sheet and risk profile of AIG have undergone dramatic change since the crisis. AIG has substantially higher capital relative to assets, much higher liquidity and has largely eliminated short term funding sources. AIG has also refocused back to its core and enduring insurance businesses by reshaping and simplifying the overall business. Multiple lines of businesses have been sold or wound down and the risks that led to its crisis have largely been eliminated. The Financial Products division that was at the core of its crisis era problems is gone. AIG exited the aircraft leasing business through a sale to AerCap. In 2016 alone, AIG completed or announced over 10 transactions generating approximately $10 billion in liquidity. This is not the same AIG.

The foundation of value and margin of safety in our AIG investment rests on its currently wide discount to book value. Importantly, book value is stronger with less downside risk today and the business is able to post sustainably higher returns given the recent Adverse Development Cover (ADC) transaction with Berkshire Hathaway, the significant fourth quarter 2016 reserve strengthening and the dramatic reductions in its historically problematic casualty lines. The reserve charge and ADC serve to strengthen and derisk what has more recently been the most troublesome aspect of AIG: their reserves. *Book value is now stronger with less downside risk enabling higher, more normalized returns and greater book value per share gains.*

As for return potential, it would not be out of line with historic norms for AIG to post 12% ROEs and corresponding valuations in the 1.5x book value range where its better regarded competitors trade TODAY. (Also of note, over the 20 years before the crisis from 1988 to 2007, AIG's average price to book value was 2.5x.) *At a 1.5x book valuation corresponding with warrant maturity in early 2021, the stock price would double and the warrant value would increase by a factor of four.* We would see a stock price at or above $120 (compared to the low $60s today) which would correspond to value in warrants above $82 (compared to the low $20s today). While it is of utmost importance that the investment can bring good returns in downside scenarios, you can clearly see how historically reasonable scenarios can lead to outsized returns.

To consider this future valuation from an earnings perspective consider that 12% returns on our more conservative measure of book value would drive earnings per share above $10 in 2021. Applying a historically reasonable 12x multiple to those 2021 earnings would bring us back to that same $120 per share value at warrant maturity. Measures of returns around 12% and value surrounding 1.5x book or 12x earnings are more than historically reasonable and have been well exceeded in the past.

Given our current heavy concentrations in financials, people often ask if this is a financials fund. We are a long term, ownership focused value fund and that is what drives what we own. Today we are heavily focused on large financials because that is where unusual value lies (note the majority of our holdings beyond these four are not in the financial space). What we strive to own are great businesses at low valuations. That will continue to drive our thinking rather than any attempts to bucket ourselves with particular industry weightings or target company sizes.

Seeking Understanding Through the Noise:
Our Defining Characteristics

- ***Perspective*** that moves past the noise of the day
- ***Patience*** to think and invest with a long horizon
- ***Temperament*** to withstand emotions and volatility
- ***Passion*** for deep intensive research
- ***Conviction*** to our best ideas

APPENDIX B

Barclays – The Old, Old Thing – Fall 2017

Banking is an enduring business that has stood the test of time and Barclays itself is an enduring franchise, having survived and thrived for centuries. With over 325 years of history in banking, Barclays can be traced to two Quakers who established themselves in 1690 as goldsmith bankers on Lombard Street in the City of London.

Today, Barclays is a transatlantic consumer, corporate and investment bank offering products and services across personal, corporate and investment banking, credit cards and wealth management with a strong presence in its two home markets of the UK and the US. Headquartered in the UK, Barclays has two primary businesses: Barclays UK and Barclays International. Barclays UK is a traditional consumer and business bank whereas Barclays International comprises a Corporate and Investment Bank and also a Cards and Payment business. Historic exposure to Africa and other emerging economies has been largely eliminated as it strives to focus on its two key businesses in the UK and the United States.

Why Now?

Barclays trades at a significant discount to book value. Significant costs associated with running down and selling non-core assets and outsized litigation costs have produced low returns and even outright losses in recent periods, largely masking the earnings power of the core franchise. But while Barclays has struggled coming out of the financial crisis with low returns, good underlying core businesses and returns are just now starting to see the light of day as the clouds of the past slowly recede. Returns moving to and beyond 10% will drive valuations to and above book value and a simple return to book value in the coming years portends a doubling of value.

Barclays has been on an accelerated restructuring path since the arrival of Jes Staley who became CEO in late 2015 after spending more than 30 years at JP Morgan Chase. The core businesses have posted strong underlying results while many non-core aspects of the business have been sold or run down. While there is still significant work to be done, much has already been accomplished, particularly in reducing and restructuring the myriad of noncore assets and businesses from legacy Barclays.

As total company returns (Group returns) move to and beyond 10%, valuations below tangible book value will no longer be reasonable. Today's valuation assumes value destruction will continue indefinitely. We do not view that as reasonable and find the opportunity to invest in an enduring franchise well below book value as highly compelling, particularly in an environment where most assets do not offer much in the way of value.
We will target value around book value with the understanding that well run banking operations have historically seen valuations at 2x book value and above. A medium term valuation at book

value would allow a doubling from today's price of $10.08. Importantly, the margin of error investing at today's prices is wide even assuming valuations at book value.

Barclays book value per ADR share at the end of Q2 2017 was $17.69 and its tangible book value per ADR share was $15.22. Given that return headwinds are now abating, we expect growth in each of these measures to be around 8% in the coming years. Looking forward two years, we can estimate book value per ADR of $20.63 with tangible book value approaching $17.75. If we assume 10% returns on this measure on tangible equity we could see earnings per ADR around $1.78. Ascribing a historically reasonable 12x multiple would yield value of $21.36, corresponding roughly to where we expect full book value in a couple years.

What Is Going Away?

Barclays set two major initiatives on its path to focus operations: (1) reduce its Non-Core operations to a point where they could be fully folded into Core operations and (2) sell the majority of its stake in its African operations so it could be fully deconsolidated from a regulatory perspective. Both of those major moves simplify the business, bolster regulatory capital, and redeploy capital and assets to core operations.

Barclays completed the accelerated rundown on the Non-Core unit at the end of June 2017, six months ahead of schedule. In the preceding three years, Barclays eliminated 95 billion pounds of Risk Weighted Assets (RWAs), sold more than 20 businesses, exited hundreds of thousands of derivative trades, closed operations in a dozen countries, returned 6.5 billion pounds of equity to Core operations and permanently reduced the company's cost base by over 2 billion pounds per year. Noncore derivative assets have been reduced by roughly two thirds and it has restructured its ESHLA portfolio, reducing its size by half. All in, risk weighted assets in the noncore division have shrunk from 110 billion pounds in 2013 to just 25 billion as of the end of the second quarter 2017.

Given its now smaller impact, Barclays will cease to break out Non-Core from a reporting perspective and what remains will be folded into their respective business units. Non-Core losses have been a significant drag on returns and that drag will abate through time providing a tailwind to future returns.

Barclays Africa Group Limited (BAGL)

Barclays has maintained a banking presence in Africa for more than a century, recently owning over 62% of Barclays Africa Group Limited. But the African business does not fit with its goal to be a UK and US dominated business. Thus, in its efforts to focus and simplify the bank, Barclays has sold down its stake in the business to just below 15% and expects to receive full regulatory deconsolidation in 2018. Barclays received a 47 basis point benefit to its capital (CET1) ratio in the second quarter of 2017 from this sell down and will receive an additional 26 basis points of capital accretion, half of which should come later in 2017 with the balance to be received upon full regulatory deconsolidation.

What Will Remain?

As CEO Jes Staley said on the last earnings call, "We are done restructuring."

Barclays is now a transatlantic consumer, corporate and investment bank centered around its two home markets of the UK and the US. The company will operate through two business units: Barclays UK and Barclays International. These businesses move forward with 81,000 people, down from 141,000 in 2015. The Company's CET1 capital level has surpassed its end state target, reaching 13.1% as of June 2017. With a simplified business and geography, strong levels of capital and liquidity, Barclays is ready to move forward on its plan to generate higher returns across its businesses, with goals to exceed 10% returns on tangible equity across the entire Group over the medium term.

Returns: Group Converging to Core and Exceeding 10%

During the second quarter 2017 earnings call, Jes Staley committed that Barclays will move Group (entire bank) returns above 10% as Group returns converge to currently higher, adjusted Core returns.

Recent year returns for Barclays have been well below what investors should demand. And they have been well below what Jes expects the bank to post. However, adjusted returns in the two core businesses would imply that Barclays overall is not as far from posting more appropriate returns levels. Continuing to improve the Core operations (especially in the Corporate and Investment Bank) and reducing the expense drag of legacy conduct and Non-Core operations can accomplish this medium term goal of exceeding 10% returns on tangible equity.

Recent Year Returns: The Ugly, the Bad and the (Becoming) Good

Recent year Group returns have been ugly: reported returns on tangible equity were 3.6% for 2016 and (0.7%) for 2015.

However, underlying adjusted results for the two core businesses have been relatively strong in recent years and much higher than reported numbers, with overall adjusted Core results ranging 9% to 11% returns on tangible equity. Breaking down further between the two remaining Core business, Barclays UK has posted consistently high returns ranging from 19% to 21% on tangible equity while Barclays International has ranged from 8% to 12%.

Non-Core losses, conduct charges, and other expense and loss headwinds have masked the underlying Core business results driving reported results to barely breakeven. Group (Core and Non-Core combined) returns even on an adjusted basis have been bad, although they have been moving higher and closer to Core returns in recent periods.

While reported Group results were significantly negative for the second quarter of 2017 we can see how underlying Group results are moving higher and closer to Core business results. Group reported results for Q2 2017 showed returns on tangible equity of negative 11%. However, two big charges drove these negative results: charges for disposition of the African business BAGL and PPI costs. Excluding these two items, Group results were 7.2%. While this remains below the Core's adjusted results of 9.7%, it is a significant step up from the adjusted Group returns of 5.8% and 4.4% in 2015 and 2016, respectively. For the full first half of 2017, adjusted Core returns were 10.4% while adjusted Group returns were 8.1%. (First half results were also adjusted for BAGL and PPI.)

As we move beyond the second quarter of 2017, any discussion of Core relative to Group results will go away as the Company focuses on driving overall Group returns to and above 10%. While the 8.1% adjusted Group returns for the first half of 2017 leaves work to be done, the direction is one of both converging to and extending beyond historical Core returns.

It should also be noted that Barclays has generated significant capital in recent years even against the headwinds we have discussed. In fact, the Company has generated roughly 100 basis points of regulatory capital each year for the past three years.

What Will Drive Higher Returns?

Barclays is targeting three key areas to drive higher returns: (1) eliminating structural reform and restructuring costs, (2) improving CIB returns and (3) driving further costs efficiencies through the Service Company.

In 2017, Barclays will have roughly 1.7 billion pounds of structural reform, restructuring and noncore costs. The Company expects 1 billion of those pounds to be removed by 2019. Costs from noncore businesses and assets will reduce as they are wound down or sold. Additionally, the costs to set up the UK ring fence bank will go away as will restructuring costs that have been incurred to reshape the company, including headwinds from the compensation charge implemented in 2016.

The Corporate and Investment Bank has seen improved results but still posts subpar returns. There are two key areas of focus in the CIB to drive higher returns: (1) redeployment of capital and assets to higher returns and (2) improving wholesale funding costs. A portion of the CIB's earning assets are earning lower than desired returns, and those assets will be reallocated to higher returning CIB clients and products. Additionally, wholesale funding costs are expected to fall over the next three years as expensive legacy debt instruments either mature or are redeemed. The CIB will also work to reduce costs by (1) aligning compensation to better reflect performance and awards, (2) reducing its real estate footprint, (3) driving technology to reduce operational costs, (4) reducing third party spending and (5) moving past structural reform costs.

Barclays is targeting a Group cost to income ratio of 60%, down from 67% in the second quarter of 2017 when excluding the PPI charge. The bank has several initiatives beyond the 1 billion pounds of savings referenced in the reduction of structural reform, restructuring and noncore costs. The foundation of this continued expense reduction effort is the newly formed Service Company. The Service Company is the hub within which the Company delivers Group wide operations, technology and functional services. Having one operation manage these services across the bank will eliminate much of the duplicative work that now occurs. As one example, the bank has integrated ten separate fraud handling departments into one. Beyond the obvious cost savings, there are other operational advantages. As one example, a retail customer could create actual fraud with a checking account but still receive a credit card based on the bank's previously heavily siloed fraud detection systems. The Service Company is also working to reduce spending with third party consultants and contractors and has embarked on a major initiative to reshape Barclays' real estate footprint ultimately concentrating people and equipment in a smaller number of strategic locations leading to lower real estate, IT equipment, data center and management costs.

Capital

Barclays reached its end state capital goal of a 13% CET1 ratio at the end of the second quarter of 2017. This is a substantial improvement from the 9.1% CET1 ratio at the end of 2013. Capital levels above 13% provide a strong foundation while recent year capital growth signifies the company's ability to generate capital even in the face of current headwinds including low interest rates, elevated pension contributions and significant conduct costs stemming from the crisis.

Liquidity levels at the bank are also very strong with a liquidity pool of 200 billion pounds as the end of Q2 2017. The company's Liquidity Coverage Ratio (LCR) was 140%, well in excess of the long run regulatory requirement of 120%. It is worth noting that much of the crisis era failures were triggered by liquidity crises. Going into the crisis, many banks carried very little liquidity AND were highly reliant on *overnight* funding. In effect, many financial institutions had to fund their business anew each and every day. If any day that funding was not there, a crisis ensued. *There was no margin for error.* Now, across the banking system, liquidity levels are well above historic levels and there is essentially no reliance on overnight wholesale funding.

With current strong levels of both capital and liquidity, Barclays is well positioned with to withstand future stressed environments. The broader banking system is also much more resilient which is important as capital and liquidity challenges have a tendency to ripple beyond any one bank.

Interest Rate Sensitivity

Asset and liability mismatches can cause problems ranging from reduced profitability to outright failure. If variable funding costs increase faster than earning asset rates, problems can and do occur, as has been seen throughout banking history. Interest rates are particularly problematic for banks today given their historically low levels. Challenges come on several fronts. Current low rates have severely hampered earnings and returns. These same low rates have also caused some banks and lenders to extend duration in order to incrementally help their current earnings, but in the process they take on much more interest rate risk than may be appropriate.

Where does that leave us? We prefer banks that (grudgingly) accept the lower returns associated with today's low interest rates so as to not take large amounts of risk if rates move higher. We also prefer banks that push expenses down to generate adequate returns against historic headwinds so they are positioned to succeed if low rates persist, but are also positioned as a coiled spring of loaded profitability if rates move closer to historic norms. We do not invest requiring such higher rates. We prefer a decent outcome in a persistent low rate environment (higher returns achieved through modest revenue growth and expense reductions) and an even better outcome as rates move higher.

Barclays publishes their asset sensitivity summarizing how they are positioned for modest improvement if rates rise. By contrast, earnings will suffer if rates move lower from today's already historically low levels. With our long term perspective however, we are more concerned with rates being flat to higher, rather than lower, and thus appreciate Barclays' positioning to avoid the temptation of adding duration. Adding duration would enhance current earnings but at the expense of leaving future earnings to hold the bag for taking too much risk today. (I would also note that, while still attractive, Barclays is not as well positioned as our core holdings, JP

Morgan and Bank of America. Both of these banks are positioned with much higher upside to rising rates and less downside to lower rates.)

People often ask "when?" as in when will the banking and rate environment get better? When will a more normalized environment bring normalized earnings, returns and valuations? I don't know. But I do know we can invest in Barclays today at trough margins and trough valuations. Returns and valuations will normalize *eventually* and we stand to be there when they do.

What happens while we wait? Patience can pay so as long as the business and franchise continue to increase in value while we wait. There are many metrics of value for a bank like Barclays including deposits, loans, relationships, etc. We can also look to growth in tangible book value per share as an indicator of value as that is the fuel from which a bank generates returns. If this measure of value is increasing, then we can wait patiently for the environment and valuations to improve.

Is Barclays a business that will increase in value as we wait? The lower returns of recent years have precluded growth in book value, but higher prospective returns should allow for such growth in this key source of value while we wait for more normalized returns and valuations.

Challenges

We expect higher returns, a return to increasing book value per share and more normalized valuations associated with those positive developments. But what remains that can stand in the way of this progress?

Barclays carries credit risk as a part of its everyday operations. But let's spend time considering the less obvious potential challenges that Barclays may face in the coming years. What are some of these potential headwinds? Barclays is likely to continue pouring additional capital into its pension, will face a hit to book value in early 2018 with the implementation of the new IFRS 9 accounting standard, and will likely face continued costs and fines related to legacy conduct issues. Additionally, the bank is subject to risks associated with interest rates and currencies.

Pension: Pension contributions will be a headwind to capital creation. Even as they have closed defined benefit schemes to new members, Barclays (and other UK banks) are required to make annual pension contributions to the extent that shortfalls are found in triennial reviews with trustees.

IFRS 9: Accounting standards for loans will change beginning January 1, 2018. In short, more of the potential estimated losses for loans will be accounted for immediately rather than as they begin to incur under present standards. This accounting change will entail a one time hit to capital and book value as estimates for loan losses increase to accommodate for new lifetime loss reserving. While Barclays has not released estimates as to what this one time impact will be, the change should not dramatically alter long term valuations. Importantly, the accounting change will not change any of the cash flow dynamics related to underlying loans.

Legal: Barclays has faced significant costs associated with poor conduct in recent crisis era years. While much of this pain is behind them, the cycle of litigation is not yet complete. For instance, the bank has yet to settle with the DOJ for mortgage related matters. Continued resolution of these matters will be a headwind.

Credit: Credit statistics on both the consumer and corporate side have been quite low by historical standards in recent years. Conservative lending since the crisis will likely lead to relatively benign credit by historical standards in the coming years. That being said, today's ultra-low charge offs and provisions will move higher. There has been recent upward pressure in the credit card space in particular. While expecting increased credit costs, they are not likely to rise to a level that would derail the overall thesis of Barclays moving beyond 10% returns and valuations to and beyond book value. The same can be said for the other headwinds including legal charges, accounting changes and pension contributions.

Rates: Barclays' rate sensitivity was discussed above but it should also be noted that rates moving lower, potentially even to negative territory, would be harmful to returns. In shortest form, it is very difficult to move rates paid on deposit below zero, even as earning asset rates move down. While longer term risks seem to line up with higher rather than lower rates, we cannot rule out the possibility of rates moving still lower from today's already historically low levels.

Currency: Barclays is a UK bank but conducts significant business in US dollars. Thus, a rising US dollar positively impacts bank financials where a slumping US dollar creates headwinds for the bank. A rising dollar however negatively impacts ADR values when pounds are translated to dollars (measures of book value in dollars as an example).

Dividend Cut: Barclays cut its dividend in early 2016 to provide a faster path to reaching its end state capital goals. While not well received by many investors, Barclays has now reached its end state capital target and plans to revisit its dividend and capital plan at the beginning of 2018. With the core businesses continuing to post strong results, increasingly less masked by such historical noncore and legacy headwinds, increases in capital return should be expected.

History Does Not Repeat, But It Does Rhyme

Until recently, Bank of America had been languishing at valuations well below book value (it still trades, attractively, modestly below book value) beset by legacy conduct costs, low to minimal returns hampered by such legacy costs, and investor perspective that could not or would not see the underlying earnings power being masked by historic headwinds.

Like Bank of America a little over a year ago, Barclays today trades at roughly 60% of book value. Its recent annual earnings and returns have been frustratingly low. Legacy fines and costs, low interest rates and a generally anemic banking environment have led to elevated costs and low returns masking the earnings power of its two enduring business: the UK consumer and business bank (Barclays UK) and the transatlantic corporate and investment bank (Barclays International).

If we can look past the elevated costs, headwinds and noise surrounding Barclays today, we stand positioned to earn outsized returns in the coming years as headwinds abate and the bank returns to normalized earnings and a more normalized valuation. Moving just to book value would bring a doubling of our money. Moving beyond book value to more historically reasonable valuations would bring yet more in the way of financial rewards.

Barclays: Enduring Franchise. Significantly Discounted Valuation.

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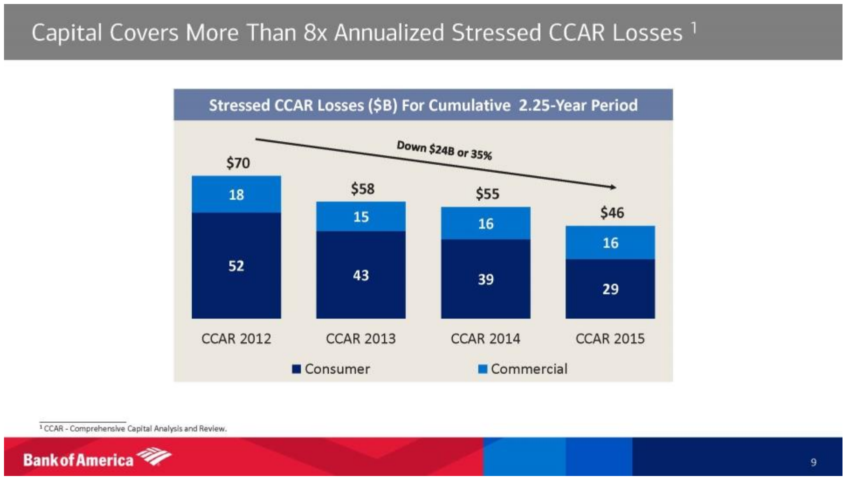
"Seeking Understanding Through the Noise"

APPENDIX C

Excerpts – Strength in the Banking System

Here are some of my own words on the strength of the banking system. First, from a summer 2016 Bank of America summary:

> Before diving deeper into the earnings power of Bank of America, consider the scale of change in the capital and liquidity levels at the bank. Capital levels have more than doubled as a percentage of assets since before the crisis and liquidity now stands above $525 billion, which is 25% of total assets. These historically high levels of both capital and liquidity serve as a strong foundation and allow for the bank to withstand even the most severe economic crises.
>
> It is also crucial to recognize the health and durability of the banking system beyond just Bank of America. As the crisis laid bare, problems in one institution can quickly infect others. But the story of Bank of America has played itself out across the banking system. Capital levels system wide are at their highest levels since the 1930s. And system wide liquidity is at levels never seen before. One data point highlights the massive change in liquidity across the financial system. First, note that large banks hold much of their cash at the Fed. Before the crisis, the banking system as a whole would hold about $50 billion in cash on deposit at the Fed on any given day. Today, the banking system holds roughly $2.5 trillion on deposit at the Fed on any given day. That is an astonishing high level of liquidity and a sea change from before the crisis. Additionally, there is essentially no short term wholesale funding in the banking system today, a dramatic departure from a very risky form of financing.
>
> To further solidify their strong foundations, all the major banks including Bank of America have simplified their businesses with a return to the more traditional forms of banking moving away from much of the risky activities and financings that contributed to the crisis.
>
> Each year the Fed conducts an annual stress putting the large banks through a hypothetical multiyear economic crisis to ensure they have sufficient capital and liquidity to withstand such an event. The tests are draconian to say the least and much worse than our recent crisis including GDP declines above 6%, unemployment above 10%, home price declines in excess of 25% and stock market declines approaching 60%, amongst other factors. Impressively, Bank of America has capital that covers more than 8x its annualized losses in such a depression-like economic environment.



It is hard to overstate how much stronger and more durable the banking system and Bank of America have become since the crisis.

One more, for good measure: This one from a 2014 discussion of JP Morgan:

Beyond an ability to generate earnings, a bank must protect its franchise from unforeseen events. Strong capital and liquidity serve to protect a bank in difficult times.

The capital levels of the broader banking system certainly did not allow for prudent risk management leading up to the recent financial crisis. The relative short term rearview mirror of many investors have caused that pain to be an ever present dynamic in their views on financial institutions and their value as productive long term investments.

The reality of today however paints a very different picture than those days leading up to the financial crisis. The banking system is better capitalized and more liquid than it has been in the past 60 years. Relating to capital levels, the average amount of equity to assets was 11.1% at yearend 2013 which is the highest amount since 1950 ***(NOTE: equity levels are even higher now, end of 2017).***

In addition to historically strong capital levels, the banking system is also incredibly liquid. At the end of 2007, the banking system had $6.7 trillion of deposits, $6.8 trillion of loans and roughly $21 billion on deposit at the Fed. Today, the banking system has $10 trillion of deposits, $7.6 trillion of loans and $2.6 *trillion* on deposit at the Fed. Bank balance sheets are incredibly liquid and in many ways underutilized.

While the above figures paint a strong story in regards to the capital levels and liquidity of the banking system, this summary is specifically about JP Morgan. The broader banking system remains important however as weaknesses can transmit through the banking system from the bad apples to the good apples in certain adverse circumstances.

JP Morgan itself has experienced dramatic growth in its capital levels and liquidity in recent years just as with the banking system broadly. By way of example, JP Morgan's risk weighted capital levels as calculated by the new Basel III standards have increased from 5% in 2007 to

> 9.5% at year-end 2013 ***(NOTE: capital levels are now at 12.5% in 2017)***. There are countless nuances when calculating Basel III capital but looking at comparably calculated levels gives a sense for the dramatic buildup in capital levels in recent years (a near doubling in the Basel III figures described)***(NOTE: they are now 2.5x the levels from pre crisis for a bank that was a port in the storm…)***.
>
> In addition to having much higher levels of capital, JP Morgan is full of liquidity. The company had $356 billion in cash at year-end mostly on deposit at the Fed. JP Morgan had another $244 billion in High Quality Liquid Assets (those that count for liquid assets under the regulators' definition of liquidity). This *$600 billion* comprises safe and highly liquid assets should the company need cash in a crisis situation. That is an incredibly large amount of liquidity relative to the total size of the balance sheet and, when combined with the higher capital levels of the company, bolsters the fortress balance sheet to withstand times of great financial stress. Beyond the $600 billion, JP Morgan has another $141 billion in unencumbered marketable securities with an average duration of 2.2 years and a AA+ rating.

And, finally, from a presentation I gave this past December:

> It is worth noting that going into the crisis many banks carried very little liquidity AND were highly reliant on overnight wholesale funding. In effect, many financial institutions had to fund their businesses anew, each and every day. THERE WAS NO MARGIN FOR ERROR. Now, across the banking system, liquidity levels are well above historic levels and there is little reliance on overnight wholesale funding.

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Seeking Understanding Through the Noise:
Our Defining Characteristics

- ***Perspective*** that moves past the noise of the day
- ***Patience*** to think and invest with a long horizon
- ***Temperament*** to withstand emotions and volatility
- ***Passion*** for deep intensive research
- ***Conviction*** to our best ideas

Brian E. Pitkin: Managing Member, URI Capital Management

Brian E. Pitkin founded URI Capital Management to follow his long time passion for deep business analysis and long term value investing. Brian began his career in Investment Banking at Merrill Lynch in Chicago, and then joined The Edgewater Funds, a Chicago private equity firm. Brian ultimately returned to family-owned Ulrich Chemical, a Midwest chemical distributor where he helped accelerate both top and bottom line growth, including a near tripling of the company's bottom line. He then negotiated and executed the sale of Ulrich to Brenntag, a global chemical distributor, before leaving to start his own ventures, now dominated by managing the fund URI Capital Partners. His background in both investing and managing businesses has contributed to his understanding of what makes for a successful business and thus a successful long term investment, while faith and family provide a strong foundation for the entirety of his life.