

10 April 2017

Dear friend,

This is the first letter that I<sup>1</sup> write under the name of Capensis Capital. In the following few pages, I'd like to introduce you to the business and explain my long-term vision for Capensis.

## Introduction

"Capensis" refers to where I learned about investments, where the business was founded and from where I hope to build a global asset management business.

**capensis: /ka'pen.sis/, [ka'pẽ:.sɪs]**

1. Adjective, (New Latin) Of, belonging to or from the Cape Province, South Africa, previously known as Cape of Good Hope.

The founding of Capensis is the culmination of my own investment philosophy, as well as the months of focused learning, reading and thinking I was privileged to enjoy after I left my previous employer. During the past year and a bit, I met with dozens of people from within and outside the industry and I'd like to thank every individual who contributed to (and challenged) my ideas. It was an incredible learning experience and I truly appreciate the open engagement that I was afforded by so many of the people I admire.

## The dream

My aim for Capensis is to build my corporate home for the next 40 years or more. I love what I do and I hope to continue doing it for decades to come. While it is impossible to predict how the future will play out, I can offer a few principles that will guide the development of the business.

Capensis is where my own long-term savings will be managed and where I hope to attract investors to co-invest some of their own capital. I hope to appeal to a group of investors who regard themselves and participate as *partners* in the business. Partners who share a similar long-term vision of value creation: rational, patient, selectively contrarian and decisive when opportunities arise.

The company will always be independent, employee-controlled and managed with the primary aim of delivering attractive investment returns after fees. Often, there can be conflict between the interests of management, shareholders and investors in an asset management business. Capensis will limit these conflicts by ensuring that the business is owned by the employees and that every future employee maintains meaningful investment in the portfolio. Everyone at Capensis will always have real skin in the game.

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<sup>1</sup> I am using the pronouns "I", "me" and "my" in this letter. It is currently correct as I am the only shareholder, director and employee, but, as the business grows, I hope to attract a handful of like-minded individuals to join me in managing money on behalf of the investors.

The portfolio will be managed with a global, flexible mandate. The long-term goal is to deliver returns (after all fees) that measure significantly above the inflation rate, thereby increasing the buying power of the investment entrusted to Capensis Capital.

The holdings will be selected based on a valuation-driven approach with a focus on margin of safety. This means that I am looking for opportunities to invest in assets when the market price is lower than my assessment of intrinsic value. This principle is one of the most important elements of long term wealth creation.

### **The reality**

The business is self-funded and financial reality limits the initial offering. Thus, the business will develop in a number of steps. Crawl... then walk... then run.

The first step is to offer separately managed investment accounts. Capensis is an authorised discretionary financial services provider and is starting out by managing individual accounts on the Interactive Brokers investment platform. While this does not offer all the benefits of an offshore fund to South African investors, it enables me to start on this journey of building a long-term portfolio.

Step two will be the launch of an offshore fund. Once a sufficiently diversified group of investors have joined Capensis, we will explore the possibility of converting individual accounts into an offshore fund. I envisage this to be a Mauritius-domiciled fund with a flexible mandate allowing investment across asset classes. It will be priced in US dollar.

The final step will be to add a rand-denominated entry into the offshore fund. The focus at Capensis will be on global investing but South African regulations still limit offshore investing for structures such as trusts and retirement money. This final entry will enable some of the trapped capital to invest in the portfolio.

### **Fees at Capensis**

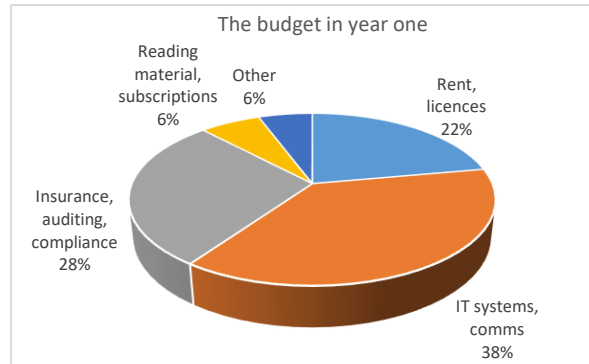
Capensis will charge investment management fees based on two elements: An on-going management fee and a performance fee.

The performance fee is to remunerate Capensis if, and only if, the business succeeds in adding value to investor accounts. I am somewhat limited by the stock broker in terms of the fee structures which can be implemented during the first phase. As the business evolves, I will be able to set a more targeted performance fee calculation.

Initially a performance fee of 7.0% (excl. VAT) will be charged on returns delivered above the previous high water mark. What this means is that, for every \$100 gain generated on the investment, \$7.98 (\$7.00 + VAT) will accrue to the business and \$92.02 to the investor. Should an investor's account decline in value, no performance fees will be charged until all declines are recouped and the account reaches a new high level.

The on-going management fee is to cover the overheads of the business. This ensures that the business will be able to withstand periods of under-performance (which will inevitably happen) but will not allow for any bonuses or profit to be earned. The on-going fee will start at 0.5% (excl. VAT).

At present, I estimate that Capensis requires \$4 million in assets under management to break even from on-going management fees alone. Once this level is crossed I will have a few options: More people could be hired and salaries paid, better systems could be purchased or a portion of the fee could be repaid back to the investors' accounts. In any event, everyone will share in some of the scale benefits inherent to the asset management business.



The level of investment fees is a very topical issue globally and rightly so. I will aim to stick to fees that are clear and, in my opinion, justifiable. Every employee of Capensis Capital, including myself, will always pay the same fees as other investors.

**Measures of success**

The main measure of success for Capensis remains the returns generated by the portfolio and the ability to do so without any significant permanent capital loss. My specific target would be to deliver a return more than six percent above US inflation in US dollar terms. This target is after all fees have been deducted.

Short-term investment returns and future market prices on individual holdings are not knowable and I don't intend to spend much time thinking or commenting about it. I will, however, focus my time on understanding businesses and thinking about how their intrinsic values compare to the prevailing market prices. Ultimately, it is the underlying performance of a business that drives the long-term investment result. While the short-term returns are largely random, I believe that my investment philosophy, consistently implemented, should deliver satisfactory returns when evaluated over the long periods. Returns should not be measured over any short period of time.

The performance of the portfolio, and that of the business, will be measured over complete business cycles, which generally means a period of five years or longer.

The first measure of *business* success will be to grow a sustainably profitable company over five years. This will depend on attracting enough investors to the portfolio and retaining them over the term. I will consider any success in this regard as evidence that my investors are satisfied with the returns generated by the portfolio. Capensis follows a liquid strategy and investors are not locked-in.

However, five years is a long period for a new business. To ensure the business is given a fair chance, I have capitalised it sufficiently and set aside a sum of money to cover personal expenses during the term. This sum is invested in South African assets to cover my family's living expenses in South Africa and will

be the only significant part of my net worth not initially invested in the portfolio. Once Capensis reaches step three discussed above, I will convert these investments into the rand-denominated structure.

However, merely being in business is not the only full measure. I also measure the business success based on the calibre of investors in the portfolio. While this measure is more subjective, I have experienced how disruptive certain types of clients can be. I aim to attract investors to Capensis who contribute positively to the overall result.

Capensis will initially open to friends and family, but as the business develops a track record, I hope to include some truly long-term capital providers as investors. These include multi-generational family offices and endowment funds. I will consider it a great vote of confidence when these institutions show interest in the portfolio.

### **Before you consider Capensis Capital**

Capensis is starting out as a one-person enterprise and I hope to selectively add to the employee base over time. I have a network of people that I share investment ideas with, but the setup is unlike the team environment at larger asset managers. I believe there are significant benefits to being independent.

The portfolio I construct will be different when compared to the indices against which many people measure investment returns. As such, the returns generated over any period will likely differ materially from that of passive index trackers. I hope to outperform these indices over the long term, but there are no guarantees. Investment markets deliver both positive and negative returns and I will undoubtedly also make mistakes. However, my capital will be invested alongside yours and my family and I shall live through the exact same returns.

Capensis is a cost-conscious business. You are unlikely to receive glossy material, flashy investor events or corporate merchandise. I aim to remain below the radar and Capensis will limit the time spent on marketing to ensure that the focus remains on the portfolio and the investment return of current clients. Investors will receive quarterly portfolio updates and a comprehensive annual letter.

### **Conclusion**

I thank you for reading about my vision for this business. Some of you might agree with this thinking and I invite you to contact me if you regard yourself as *Capensis partner material*.

Regards

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## **Disclaimer**

This document is intended for clients of Capensis Capital (Pty) Ltd. All data provided by Capensis, unless otherwise stated, as at 31 March 2017.

Capensis Capital (Pty) Ltd is an authorised Financial Services Provider, regulated by the South African Financial Services Board. Registered office: Ground Floor, Liesbeek House, River Park, Gloucester Road, Mowbray, Cape Town, 7700

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. You may get back less than you invested. Past performance is not a guide to future performance.