IBV
CAPITAL

Dear Partners,

As we reflect on the present state of our investment portfolio, we recognize that over 50 percent of our holdings exhibit underlying characteristics that will generate idiosyncratic returns. While this may not be apparent one month to the next, we're confident that specific embedded catalysts that exist in many of our positions will manifest themselves over time.

For this reason, instead of sharing our perspective on the state of global economic growth, trade disputes and other geopolitical events, we are devoting this quarter's partnership letter to updating you on some of the investments within our portfolio. While updates such as these are important for us to convey, so too is the notion that when you invest alongside us, you're investing in our wholistic strategy and demonstrated capabilities, and not a single investment idea – as these will change over time.

With that in mind, we'd like to share with you some developments that have transpired at Ascendant Group. During the quarter, Ascendant Group (AGL), whose primary asset is Bermuda Electric Light Company (BELCO), announced continued progress on operational improvements. Specifically, despite seeing resistance to executive-level restructurings last summer, an early retirement program offered to BELCO staff received widespread acceptance. This program will reduce staffing by 50 people, or 16% of company employees. When combined with other announced and expected efficiency initiatives, we anticipate AGL will realize an impressive level of cost savings this year and beyond.

We were also encouraged to hear AGL engaged an independent advisory firm, Guggenheim Partners, to conduct a review of strategic alternatives to optimize shareholder value. It was later confirmed that management will initiate a process to sell the company. In North America, an announcement of this nature would usually prompt increased trading volume and a rise in the company's share price. In Bermuda, where investor and financial market acknowledgements of such developments is generally more muted, no shares of AGL would trade on the strategic review announcement day.

As the largest independent shareholder of AGL, we're pleased to see management actively working toward unlocking shareholder value. Fortunately, as a result of realized and planned operational improvements, the company's prospects have never been brighter. This means shareholders enjoy strategic alternative options to realizing the true value of AGL, such as re-listing the company's shares on another exchange, if an appropriate offer doesn't transpire. The company is in a wonderful position on multiple fronts, so we continue to be optimistic about its future.

Capitalizing On Conditions

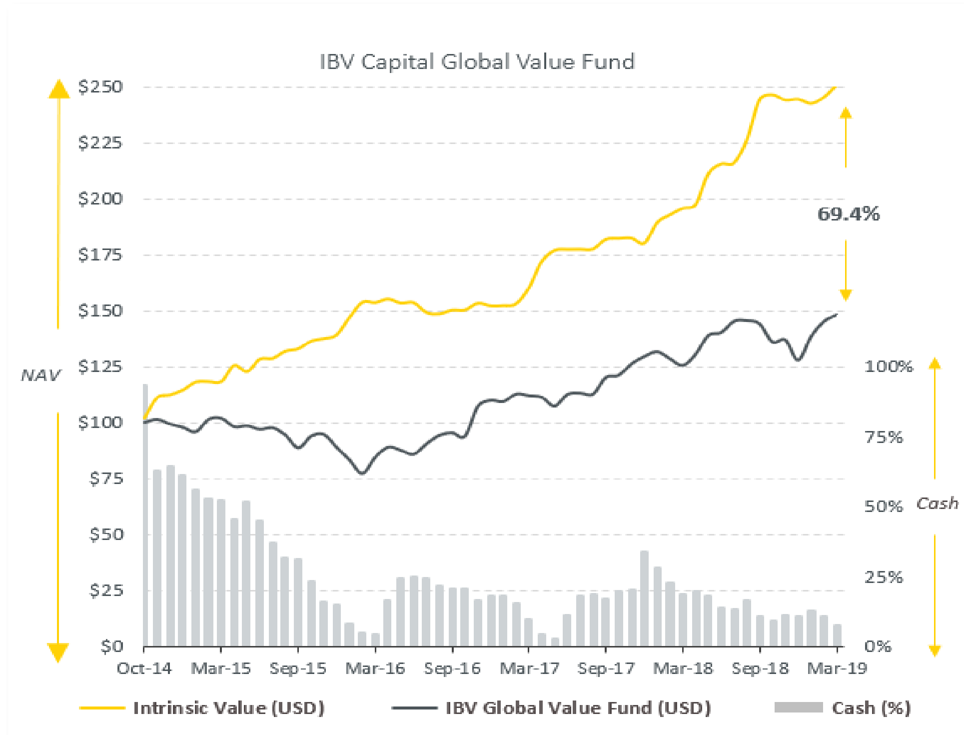
The market value of our IBV Capital Global Value Fund increased by 13.3% (net of fees) in the first quarter of 2019. Importantly, the intrinsic value[1] of our portfolio advanced by 2.6% during the quarter. For comparative purposes, during the first quarter of 2019, the MSCI World Index advanced by 12.5%.[2]

Late last year markets exhibited signs of stress. At the time, we assessed that the market values of a select few investments already in our portfolio were well below their intrinsic values, and therefore deserved a more meaningful allocation. To capitalize on the environment, we increased our weightings in these investments. This contrarian approach has already produced strong results.

Our investment activities at the end of 2018 contributed to the increased market value of our portfolio this quarter – as did the increased market value (albeit delayed) of Ascendant Group following the announcement of their strategic review. As a result of these movements, the gap between the intrinsic value of our portfolio – what we think our portfolio is worth – and the market value of our portfolio has narrowed to 69.4%.

[1] We would encourage all new readers to visit the "Our Liquid Conglomerate" section of our Q2-2016 investment letter to assist them in understanding the meaning and importance of our portfolio's intrinsic value.

[2] "IBV Capital Global Value Fund" consists of USD$ IBV Capital Global Value Fund LP Class A unit returns, net of fees. Inception date of this class is September 1, 2014. "Portfolio Intrinsic Value" represents IBV's internally calculated intrinsic value for the cumulative securities within the IBV Capital Global Value Fund. "MSCI World Index" is based on the USD$ returns MSCI World Free NR Index. Full investment disclosures can be found on Page 7.



At the end of 2018, we shared an assessment of the future return profile of our portfolio.[3] That analysis centered on the degree to which the market value of our portfolio was below the intrinsic value of our portfolio. Since the gap was near its historical highs, we suggested, based on our experience, that our future returns would be higher than usual. Our returns so far in 2019 provide further concrete evidence that when our intrinsic value gap is widest, our future returns are most attractive.

Spring Cleaning

Before we get to the new crisp white shirt, we're going to air out some dirty laundry. During the quarter, we sold our investments in Helmerich & Payne (HP) and National Oilwell Varco (NOV). Both firms provide services and equipment to the oil and gas industry.

At the time of our investment, we took comfort in the fact that these two companies, for their respective specializations, were world-class operators. Unfortunately, their reputations did little

[3] We would encourage all new readers to visit the "Boxing Day Sale" section of our Q4-2018 investment letter to assist them in understanding how we assess the relationship between the fund's future return profile and its intrinsic value gap.

to offset a multi-year slump in oil prices. With limited visibility into the realization of our original investment theses, we decided to move on from these holdings.

For both companies, our overriding thesis was that despite market fears we had reached peak oil the world would be unable to transition away from oil entirely in a short period of time. Our conviction, therefore, since NOV and HP provide services and equipment to oil and gas drillers, was that they would continue to see demand based on volume pumped – which we determined wouldn't change by much – and be less impacted by temporary changes in the price of a barrel of oil. In other words, because of inelastic demand in end oil markets, there would be inelastic demand throughout the oil and gas equipment supply chain, particularly for high-quality providers.

We were accurate in our general thesis – the world still needs millions of barrels of oil a day – but we overlooked an important nuance in the underlying dynamics of both companies' equipment demand. While NOV has a strong onshore equipment business, their core competency is offshore drilling platforms. Naturally, extracting oil from sea beds in harsh weather conditions is a more expensive proposition, so when oil prices fell and remained depressed, there was a material pullback in offshore oil drilling activity – and it still has not completely recovered. This has stifled demand for much of NOV's equipment. At HP, the impact came in the form of cancelled rig contracts and reduced day rates realized on any new rig contracts. This pricing pressure was despite HP's clear advantage in rig technology.

Ironically, we can attribute a source of downward pressure on oil prices to the technological advancements NOV and HP continue to achieve with drilling equipment. Fittingly, these were competencies that drew us to these companies in the first place. Without NOV's and HP's evolutionary equipment, we suspect some oil fields being drilled today would be uneconomical. For more conventional oil fields, without them, the cost of extracting oil would also be much higher. With more fields available and production costs reduced, we appreciate that it was only natural for oil prices to fall – and remain depressed.

From our perspective, these dynamics make it challenging to see if HP can maintain any positive momentum. It also places into question whether (or when) offshore drilling will be revived, and thus be a driving force for NOV's revenues and profitability. While we experienced a loss on both investments, as a result of our approach to investment weightings the overall impact on our performance was manageable.

Over the course of the last year, we purchased various series of the preferred shares of Element Fleet Management (EFN), the largest provider of light-duty fleet vehicles and services in North America. Element Fleet Management began as Element Financial, a fleet management and

equipment finance company that, by 2016, was split into two publicly traded companies: EFN and ECN Capital. Since the split, EFN's standalone corporate history has been a rocky one.

In 2018, following an aggressive acquisition program designed to achieve critical scale, EFN encountered issues with customer attrition as they attempted to integrate their newly purchased platforms. These challenges were exacerbated by poor performance at 19th Capital, a joint venture between EFN and trucking company Celadon Group. These developments led to concerns that a 19th Capital write-down, prompted in part by a conversion to IFRS 9, would lead to EFN violating their bank debt covenants.

During this period of stress, we assessed that EFN's $1.7 billion in tangible equity, which was inclusive of the $776 million carrying value of distressed 19th Capital, would cover the approximately $700 million in preferred equity outstanding. Considering this coverage, we felt it would take a substantial deterioration in EFN's core fleet offering before our preferred shares would become impaired. Since their fleet management business has historically experienced high retention rates as a result of the mission critical function it serves for customers, this seemed unlikely.

Despite having a strong underlying business model, it was evident to us that EFN's stretched balance sheet and upcoming convertible debt maturities would create the need to build capital. In our view, the simplest solution to EFN's capital problem was a dividend cut. This would be credit enhancing and therefore beneficial to preferred shareholders. By purchasing various EFN preferred shares at a 12-21% discount to par with a mid-7% dividend yield, we felt we were being well compensated for the given level of risk.

Shortly after our purchase, we learned that core components of our investment thesis would actually work out better than we initially expected; a capable new management team was installed, the dividend was cut by 40% and $345 million in equity capital was raised – all positive catalysts for our preferred share investments. Unfortunately, while this was positive for preferred shares and presumably negative for equity shareholders, only EFN's common shares have shown meaningful appreciation in value.

It was only after company specific elements of our investment thesis were realized that 5-year Government of Canada bond yields began to decline. This lower yield led to downward pressure on the value of these EFN positions, because it was reducing the implied dividend yield holders would receive when the dividend rates would reset.

While admittedly a setback, we are still very pleased with the return optionality these preferred shares provide us for the risk that we're taking. We envision realizing attractive returns through improving credit conditions at the company over time, as well as the possibility the preferred shares are retired as a result of their high cost and tax-inefficient nature. A sale of the company could also achieve a similar outcome. We're encouraged by the broader turnaround currently taking place at EFN, and, because of our purchase price we still see us enjoying an equity like return on the investment.

To use a baseball analogy, the preferred shares of EFN recently shifted from our farm team to our big-league squad. For all our positions, before they make it to "the show," which consists of receiving a larger portfolio weighting, we must have comfort that our investment thesis will be realized. Our due diligence has given us confidence this will be the case for EFN.

Today, our farm team has some very talented prospects, and we anticipate many of them being added to our big-league roster. Equally important, our scouting process has identified a few prospects with very promising futures and we're carefully considering whether they should be added to our farm team – with the expectation that many of them make it to the major leagues.

A New Home

After spending our formative years in Yorkville, we're moving to a new office downtown on Bay Street. We've come a long way since our humble beginnings. IBV Capital started as a team of one. Today, after tremendous growth, we have in place an impressive investment team that's perfectly complemented by a remarkable operations team. We're fortunate to have a firm with so much talent and dedication.

Our new office will provide IBV Capital with the space to further grow our team. Despite our love for Yorkville, a place we've called home for the past five years, the team is very excited to move downtown.

Sincerely,

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