BOYLE CAPITAL

July 17, 2018

Dear Investor,

Investment legend Bob Farrell, head of research at Merrill Lynch from 1967 to 1992, was known for his ability to cut through the noise in markets. His levelheaded, commonsense approach allowed him to enjoy nearly three decades of success on Wall Street, a period which included the go-go era of the 1960's as well as the bear market of 1973/74 and the 1987 stock market crash on Black Monday. Retired for some time, Farrell's list of "10 market Rules to Remember" is a great list that has stood the test of time:

1. Markets tend to revert to the mean over time
2. Excesses in one direction will lead to an opposite excess in the other direction
3. There are no new eras and excesses are never permanent
4. Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways
5. The public buys the most at the top and the least at the bottom
6. Fear and greed are stronger than long-term resolve
7. Markets are stronger when they are broad and weakest when they narrow to a handful of blue-chip names
8. Bear markets have three stages-sharp down, reflexive rebound and a drawn-out fundamental downtrend
9. When all the experts and forecasts agree something else is going to happen
10. Bull markets are more fun than bear markets

As I study markets and talk to investors today, I can't help but think of several of Farrell's rules. First is rule number 7. So far this year, three stocks account for 78% of the market return (Amazon, Netflix and Microsoft). In total for 2018, only six stocks (Amazon, Netflix, Microsoft, Apple, Google and Facebook) make up 98% of the S&P 500 returns and 105% of the Nasdaq 100 returns. The last time we saw such narrow leadership in the stock market was in 1999 when a handful of technology stocks dominated the markets (just 7 stocks accounted for the S&P 500 return in 1999). Coincidentally, this was a period where growth stocks significantly outperformed value stocks just as we have seen over the past few years. Of course, in March of 2000 the tech bubble collapsed and from 2000-2002 there was a shift from growth toward value (rule 1 and rule 5). The tech heavy S&P 500 was down three consecutive years as the excesses were worked off (rule 1). Some of the darlings such as Microsoft took more than 15 years to recover and some like Cisco Systems have yet to recover (Rule 2).

The S&P 500 is currently 24.9% weighted in technology. Six stocks (Facebook, Amazon, Netflix Google, Microsoft and Apple) have gone from 6% of the S&P 500 in 2010 to nearly 15% today. During that stretch, growth strategies have trounced value strategies. We know that these trends cannot last forever, yet investors are coming up with all sorts of reasons to justify why they might (rule 6).

Consider a company like Netflix. At today's market cap of more than $170 billion, investors are paying around $13 for every $1 of sales. To give you an idea of what the current valuation implies, consider what Scott McNeely, former CEO of Sun Microsystems had to say while reminiscing about the crazy valuation bestowed on his company during the 2000 bubble:

"At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have a zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next ten years, I can maintain the current revenue run rate. Now having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?"

Shares of Sun Microsystems plummeted from $64 to $5 when the tech bubble collapsed. The company ultimately sold to Oracle in 2010 at $9.50 a share, some 85% below the all-time high.

At the height of the dotcom era there were 36 stocks within the S&P 500 trading above 10 times revenue. Among the FANG stocks today, both Netflix and Facebook trade for more than 10 times sales. There is no question that both Netflix and Facebook are revolutionary companies with enormous addressable markets. However, the growth rates and conditions necessary to justify current valuations require a near perfect future to unfold. What happens if investors' appetite for risk changes and they are only willing to pay 4 times sales (for reference Apple today trades at 3.8 times revenue)? Assuming unchanged fundamentals, investors in Netflix would suffer a loss of nearly 70% and there is a good chance it could take years perhaps even decades to recover.

Markets never ring a bell when trends are about to change, so it is only with hindsight that things become clear. However, with central banks around the world beginning to raise interest rates and market participants seemingly willing to pay any price for higher growth, investors would be wise to remember Bob Farrell's rules.

Update on Portfolio Companies

Birchcliff Energy

Shares of Birchcliff were up 27% on the quarter and are now up approximately 10% on the year. As we wrote last quarter, every calendar year since 2004 when Birchcliff went public its' shares have touched book value at least once during the year (see historical valuation on the next page).

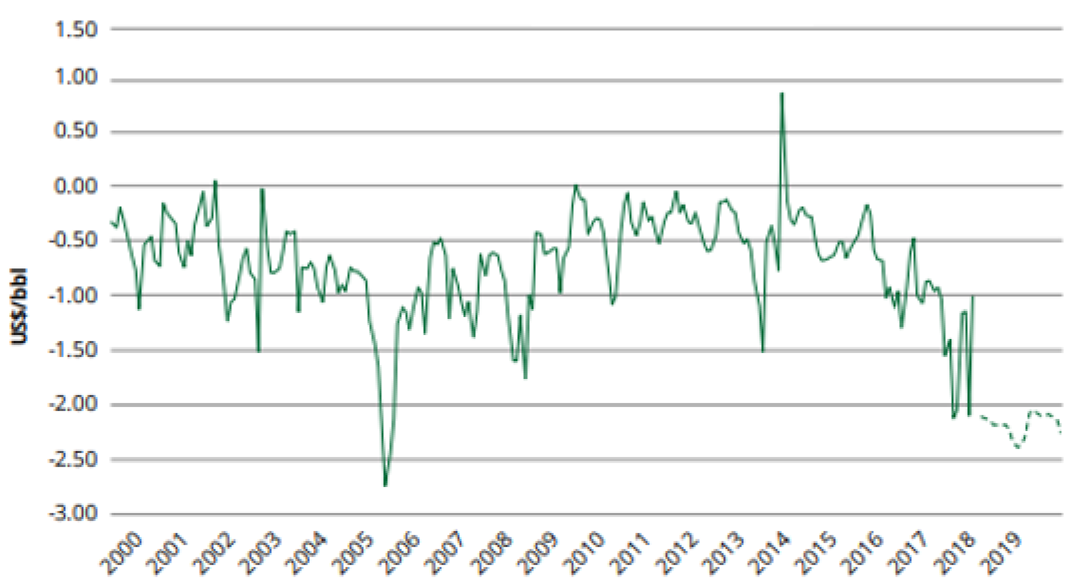
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
BVPS	$ 4.48	$ 4.45	$ 5.20	$ 6.08	$ 6.42	$ 6.68	$ 7.21	$ 6.65	$ 6.15	$ 6.42
Stock Price High	$ 8.85	$ 10.81	$ 15.46	$ 13.99	$ 8.97	$ 14.85	$ 9.24	$ 10.42	$ 8.81	$ 5.13
Stock Price Low	$ 3.44	$ 2.84	$ 9.17	$ 5.08	$ 6.82	$ 7.42	$ 3.45	$ 2.83	$ 3.89	$ 3.07
High P/B	1.98	2.43	2.97	2.3	1.4	2.22	1.29	1.57	1.49	0.80
Low P/B	0.72	1.76	1.76	0.83	1.06	1.11	0.58	0.43	0.62	0.47
Cash flow per share	$0.57	$0.76	$1.04	$0.88	$1.22	$2.03	$1.06	$0.74	$1.20	$1.36E
P/CF High	15.6	14.2	14.9	15.9	7.4	7.3	8.7	14.1	7.8	3.78
P/CF Low	6.0	10.3	8.8	5.8	5.6	3.7	3.3	3.8	3.2	2.26

As of 7/14/18

Figures in $CAD

At approximately 80% of book value, shares remain attractively priced with several key catalysts we believe can drive shares toward book value and beyond in the coming quarters. Most significant of which is Canada LNG, the $40 billion liquified natural gas (LNG) export facility under consideration for the coast of British Columbia (BC). Nearly every week signs emerge that this project is going to get the green light from Shell and its' partners before the end of 2018. A Final Investment Decision (FID) would be a game changer for western Canadian natural gas as it would provide a clear path for growth and serve to close the historically wide price differential that exists today between AECO gas and Henry Hub due to a lack of takeaway capacity for western Canadian producers such as Birchcliff (see chart below).

AECO to Henry Hub historical differential

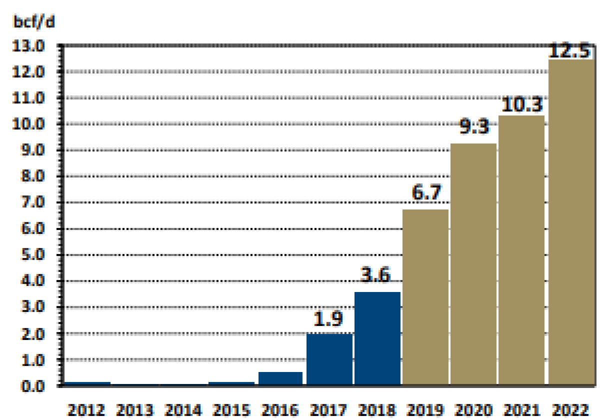


Source: EIA, DOB, CME, and NGX

While Shell moving forward on Canada LNG is unlikely to bring a return of 2012 valuations anytime soon (the last time LNG was near a positive outcome in Canada), a positive decision is likely to result in a meaningful uplift in valuations (see historical valuation chart for 2012 multiples) as members of the project will need to line up supply well in advance and thus those like Birchcliff with decades of reserves are likely to be attractive acquisition targets.

In addition to Canada LNG getting the final approval, natural gas prices could see strength this fall if inventories are unable to be replenished heading into the 2018 winter season. As we write this, natural gas inventories in the U.S. are 25% below year ago levels and 19% below the five-year average. Supply growth is running ahead of historical levels right now, so weather is likely to be the swing factor in determining inventory levels heading into the 2018 winter. Even if inventories can replenish by winter (that is a big *if* at this point given we are 50% into the injection season), U.S. LNG export demand is set to explode over the next 18 months as shown on the chart below.

Figure 22. United States annual LNG exports



Source: GMP FirstEnergy, U.S. DOE/EIA

The upcoming surge in LNG demand combined with the current inventory deficit should prevent inventories from returning to the elevated levels we saw in the fall of 2017 and therefore should keep prices around $2.8-$3/mcf with the potential for significantly higher pricing this winter if weather is below normal. In the meantime, favorable oil and condensate pricing should allow Birchcliff to generate significant free cash flow that can be used opportunistically for production growth if prices warrant and/or for debt reduction and dividend increases (the current dividend yield is approximately 2.5%).

Fannie Mae and Freddie Mac Preferred (FNMAS/FMCKJ)

The preferred shares of Fannie Mae and Freddie Mac have been responsible for nearly all of any portfolio declines in 2018 to date as investor fatigue and frustration have resulted in shares trending lower. While the timing of a final resolution remains uncertain, our confidence in substantial gains upon a resolution remains as strong as ever and in fact has strengthened since the beginning of the year as the result of several developments:

1. FHFA Capital Framework: On June 12th, the FHFA (regulator to Fannie Mae and Freddie Mac), issued proposed regulation on capital requirements for Fannie Mae and Freddie Mac (aka GSEs). The new proposal would target the GSE's combined capital at $180.9 billion or roughly 3.24% total capital to assets. Such requirements are nearly identical to the numbers proposed in the Moelis Blueprint that was introduced in June 2017 and which Boyle Capital endorses. Following a 60 day comment period, we expect the next step taken by the FHFA later this year will be to request capital restoration plans from Fannie and Freddie in the event they were released from conservatorship.
2. Office of Management and Budget (OMB) Proposal for Reforming and Reorganizing the Government: On June 21st, the OMB released a plan for reorganizing the government and included as part of the plan was a proposal for reorganizing housing finance. The plan called for reducing the footprint of the GSE's in the housing market, which is something that Treasury Secretary Mnuchin has publicly supported over the past 18 months. Under the OMB proposal, Fannie and Freddie would be converted into "fully private entities" that would be owned by shareholders. Following the release of the proposal, Senator Corker issued a statement applauding the administration's plan suggesting the framework unveiled by the OMB closely resembled the approach laid out in legislative drafts developed on a bipartisan basis in the Senate last winter. According to an article in *The Wall Street Journal* on December 7, 2017, under the drafts referenced by Corker "preferred shareholders of Fannie and Freddie could be made whole or close to whole." The OMB's proposal and Corker's statements reinforce the idea that Fannie and Freddie are likely to be central to any reform that takes shape and there simply isn't any appetite to radically disrupt the system by winding them down such as was contemplated under the Obama Administration.
3. Testimony by Treasury Secretary Mnuchin: On July 12th, Treasury Secretary Steven Mnuchin testified that his "strong preference, as part of GSE reform, is that we create a system of competition….and that if other people wanted to compete with the GSE's they could." Mnuchin went on to state that housing reform will be a top priority of the administration in the next Congress and if Congress can't get it resolved (a safe bet given the current state of politics) then they would look at administrative options (in early June, Mnuchin's assistant Craig Philips told an audience that the administration can accomplish most of their objectives outside of Congress if necessary). Mnuchin also reinforced his determination to resolve the conservatorship and maintained that any solution would need to protect the taxpayers.

The Trump administration has made it clear they eventually want out of the ownership of Fannie and Freddie and they want private capital to step in. The only way to accomplish both objectives is to deal with the existing conservatorship and in turn preferred shareholders. As such, we continue to believe it is a matter of ***when***, not ***if*** Fannie and Freddie are reformed. At a 3 to 1 reward vs. risk assuming par value of $25, shares remain extremely attractive and worth the volatility in our opinion.

AIG Warrants

Shares of AIG and in turn the warrants have underperformed over the past year as the insurance giant dramatically increased reserves and then absorbed significant losses from a record hurricane season last fall. As a result, tangible book value has fallen from $75 per share at the end of 2016 to approximately $70 per share today. Imbedded in the book value today is approximately $10 per share of excess capital which provides an additional margin of safety to the shares trading at roughly 80% of book value. According to new CEO Brian Dupperreault, AIG's focus for the remainder of 2018 will be improving profitability relative to the capital base it employs with the stated objective of returning the insurer to a sustainable underwriting profit by the end of 2018. If successful, AIG will be able to close the gap that exists versus peers (nearly all trade above book value) and shares should respond accordingly. While the turnaround story at AIG has been anything but smooth, Dupperreault's success in driving profitability along with shareholder returns at ACE and Marsh and McLennan during the 1990's and 2000's suggests he is capable of delivering for shareholders of AIG. Expectations currently imbedded in shares are low and thus if Dupperreault is successful in getting to sustainable operating profit by year end, the common and the underlying warrants (which move disproportionately to the common) should have considerable upside from current levels.

Amgen

A recent addition to the portfolio, shares of Amgen trade at decade low multiples relative to the market as fears over healthcare legislation companies has weighed on the sector. A similar cloud hovered over healthcare stocks during the early 1990's when it was feared the Clinton Administration was going to overhaul the U.S. health-care system. The health-care reform package ultimately was defeated and healthcare securities enjoyed a multi-year run as they returned to historical valuations. While a return to historical levels would be a huge tailwind for Amgen shares, we believe investors can earn an attractive return from the dividend and earnings growth alone given management's track record of dividend increases and share repurchases. Since 2011 when it first implemented a dividend, Amgen's annual dividend has grown more than 37% per year from $0.56 to $5.28. In addition, shares outstanding have fallen to 725 million from 950 million over the same timeframe and since 2003 shares outstanding have declined by more than 40%. Amgen's balance sheet is rock solid today, containing more than $40 billion in cash versus around $30 billion in debt. In 2017, Amgen generated an unleveraged return on equity of more than 30% with a net profit margin exceeding 40%. This combination of balance sheet strength and significant free cash flow generation makes Amgen one of the highest quality companies in the large cap universe. At around 15 times trailing earnings per share versus a market closer to 19 times trailing earnings, we think shares are attractively priced with a considerable margin of safety.

Oracle Corporation

Another recent addition to the portfolio, Oracle Corporation (ORCL) has long been on our radar and is a great example of the type of investment we seek. Undergoing a transition from on-premise software licenses to cloud based subscriptions over the past several years, growth at Oracle has slowed and thus shares have languished as growth investors have moved on. Given Oracle's size, transitions of this magnitude don't happen overnight, yet we believe the company is near an inflection point and the current price provides an attractive entry level for long term oriented investors. Growing at more than 30% annually and now over $6 billion in annual sales (on premise revenue should be relatively flat), we believe the cloud business will begin to drive overall earnings per share at double digit rates again. With peers such as Microsoft and SAP trading at 23 times earnings versus only 14.5 times earnings for Oracle, shares have the potential to deliver attractive returns over time from a combination of dividends, EPS growth and multiple expansion.

Summary

Over the years we have achieved success by investing with conviction in painstakingly researched, deeply undervalued opportunities. Such an approach requires patience and a willingness to stay the course as an investment thesis plays out. The volatility of the last year has not been desirable, but there is light at the end tunnel. Our major holdings remain substantially undervalued and should provide sizeable appreciation as they play out.

Sincerely,

Brian F. Boyle, CFA

The S&P 500 is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The index is used for comparative purposes because it approximates what an investor could earn from a passive investment in the general securities market.