BOYLE CAPITAL

October 22, 2018

Dear Investor,

Since peaking in February of 2017, the past 19 months have not been ideal for investors in our equity and value strategies (of which I am among the largest). While we believe our forward expected return is as high as, if not higher than, it was in January of 2016 before portfolios rose an average of 47.08% over the next year; we think it is important to explain what has happened and where we expect the strategies to go from here.

Since our inception in 2004 we have always pursued a focused approach believing very much that Charlie Munger (Warren Buffett's partner at Berkshire) had it right when he said, "Being prepared on a few occasions in a lifetime to act promptly in scale in doing some simple things will often be enough to make the financial results of that lifetime quite satisfactory."

This approach has allowed us to make substantial profits in names such as Bank of America, MBIA and Steak n' Shake to name a few. What Munger also said though, and we can certainly confirm, is that "there is no free lunch." The downside to a focused approach to investing is that there will be times where portfolios fluctuate considerably and not always in the same direction as the market. On several occasions over the past decade and a half (Bank of America and MBIA are two instances), we have had our patience tested as we waited for major holdings to play out. Ultimately, we were rewarded for hanging tight through those challenging periods. Like a ball held under water, profitable businesses eventually find their true level.

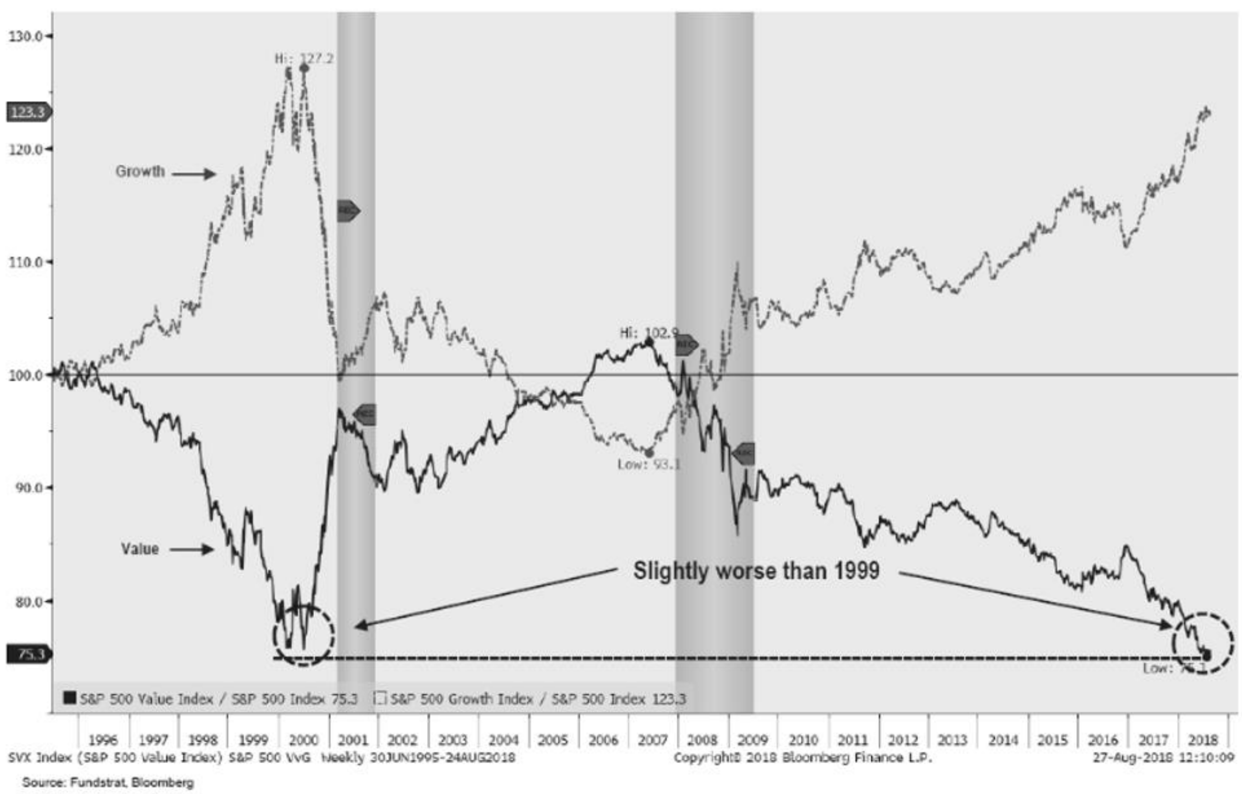
Today we find ourselves amidst a stretch of underperformance due to several factors. First, we have committed a few investment sins. Not trimming shares of Birchcliff Energy in early 2017 was one of them. This has been a costly mistake in terms of opportunity cost and one we will not repeat. As further detailed in this communication, since that time the company has gotten substantially stronger financially and has the potential to make up considerable lost ground in portfolios by just returning to levels it has touched in every calendar year since going public.

Likewise, our "special situation" investments in the preferred shares of Fannie Mae and Freddie Mac have greatly influenced portfolio volatility since the end of 2016. Even though we have made profits on these investments in our average portfolio, we have watched sizeable "unrealized" gains dissipate as well. Watching broad market averages move higher while shares of Fannie and Freddie have languished has been difficult. However, as we have seen in the past with this investment and address in greater detail under the position update, a single tweet or comment by members of the administration can make up a lot of lost ground and signs are emerging that we might be close to such a point.

1230 Office Plaza Drive • West Des Moines, IA 50266 • **Phone** 515.327.1870 • **Toll-free** 877.327.1870 • **Fax** 515.619.5719 • www.boylecapital.com

Most importantly today, we find both positions to represent tremendous values at these levels with sizeable "margins of safety," which is not something that can be said about many of the market tech darlings. As we have pointed out before and show again below, growth stock investors have had significantly more fun over the past few years than value investors such as ourselves.

Figure: S&P 500 Growth and Value relative price performance (vs S&P 500) past 25 years
Price ratio: Style / S&P 500. Since 1995



Source: Fundstrat. Data for the time period 10/1/1995 – 9/30/2018.

Just six stocks (Facebook, Amazon, Apple, Netflix, Microsoft and Google) make up nearly 18% of the S&P 500 today (up from 9% in 2014) and have largely been responsible for the historic outperformance growth has enjoyed relative to value.

As we write this, October thus far has seen volatility return to the broad market with the largest declines occurring in the tech heavy Nasdaq. According to a recent report by ***Sentiment Trader***, there are three times more stocks hitting 52-week lows than hitting 52-week highs. The last time this ratio was this high? December 1999. Over the ensuing two years, growth stocks corrected significantly relative to value stocks as rates started rising and growth stock valuations compressed. Alligator jaws like seen in the chart above always close. This time will be no different and we are well positioned for when it does.

Update on Portfolio Companies

Birchcliff Energy

On October 2nd, Royal Dutch Shell announced the long awaited Final Investment Decision (FID) for Canada LNG. Along with partners, Shell has committed to construction of a large liquefied natural gas (LNG) export project in Kitimat, British Columbia. When construction is completed (likely 3-5 years), the plant capacity of 2 billion cubic feet daily (bcf/d) would expand Canada's export market by as much as 40%. Given the fact that much of the cost is fixed, it is likely Shell and its partners will immediately follow-on with continued construction to double capacity to 4 billion cubic feet per day. In addition to Canada LNG, it is expected that several more LNG projects will go Final Investment Decision by the end of 2019. Eventually the partners in these mega projects will want to secure more long-term supply ahead of project completion. The quickest and most secure way to do so would be to acquire a resource rich producer like Birchcliff while valuations and gas prices are near trough levels.

In the meantime, Birchcliff is positioned to generate significant free cash flow over the next year. Using current oil and gas prices, Birchcliff will generate approximately $170 million of excess cash flow in 2019. Assuming it is used for reducing debt, Birchcliff is on track to reduce debt by more than 30% from the beginning of 2018 which would leave it with a debt to cash flow ratio of approximately 1.0 compared to 1.90 today. For comparison, Arc Resources, a peer with land adjacent to Birchcliff, sports a debt to cash flow ratio of 1.0 today and trades at roughly 7 times cash flow and 1.30 times book value. As shown below, Birchcliff trades for approximately 70% of book value and 3.3 times cash flow. As we wrote last quarter, every calendar year Birchcliff's shares have touched book value and/or 7 times gross cash flow at least once during the year. Reaching such metrics from today's levels would result in a gain of 40% to 112%.

	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 (Current)	$ 8.85	$ 10.81	$ 15.46	$ 13.99	$ 8.97	$ 14.85	$ 9.24	$ 10.42	$ 8.81	$ 4.55
Stock Price Low	$ 3.44	$ 2.84	$ 9.17	$ 5.08	$ 6.82	$ 7.42	$ 3.45	$ 2.83	$ 3.89	$ 3.07
High (Current) P/B	1.98	2.43	2.97	2.3	1.4	2.22	1.29	1.57	1.49	0.71
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	3.3
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 10/18/18

Figures in $CAD

With likely only four more weeks of natural gas injections remaining, it appears almost certain that we will enter the winter season with natural gas inventories at the lowest level in the past six years. Consequently, the potential for price spikes this winter on any cold weather is significant and unhedged Canadian producers like Birchcliff would stand to benefit the most since the U.S. would increase its' imports from Canada. In the absence of rising natural gas prices, Birchcliff remains an attractive acquisition target for either an LNG partner or a peer such as its' neighbor Arc Resources given it would be immediately accretive.

Fannie Mae and Freddie Mac Preferred (FNMAS/FMCKJ)

While it has felt like a multi-year donkey ride through hell at times, we remain confident in our preferred equity investments, and believe 2019 is the year we are rewarded for staying the course. Consider recent developments in understanding our confidence.

Last week, Craig Phillips, Treasury Secretary Steven Mnuchin's top housing advisor, told a crowd at the Mortgage Bankers Association 2018 Annual Conference that the Trump administration is working to end the conservatorship of Fannie Mae and Freddie Mac. According to Phillips, "the administration advocates ending the conservatorship of Fannie Mae and Freddie Mac and returning them to private ownership."

The comments by Phillips echoed a proposal by The Office of Budget and Management (OMB) last June to overhaul the federal government which included returning Fannie and Freddie to private ownership.

Phillips went on to state in his speech that housing reform is a "very important" goal of Secretary Mnuchin's, adding that the Treasury's central position is that reform is desperately needed. Secretary Mnuchin himself during an interview on September 27th highlighted housing reform as a priority of his in 2019 and something he is "very much focused on."

On January 6th of next year, the term of the current director of FHFA (primary regulator of Fannie and Freddie) Mel Watt expires. Secretary Mnuchin has stated the Trump Administration intends to replace Watt with someone more aligned with their agenda. Based on a recent update in ***Asset-Backed Alert***, the Trump Administration believes the FHFA director has the power to transform Fannie and Freddie under the 2008 Housing and Economic Recovery Act, which created the regulator while giving it oversight of the agencies. According to the same report, the Administration also believes it has the authority to initiate the process of removing Fannie and Freddie from government conservatorship and beginning the re-privatization process.

Secretary Mnuchin has repeatedly stated that any housing reform solution must "protect taxpayers and will be dependent upon the GSE's [Fannie Mae and Freddie Mac] being capitalized." The Treasury owns warrants entitling it to purchase up to 79.9% of the common equity of Fannie Mae and Freddie Mac for a penny. As we have maintained and has become clearer from the inception of our investment, there is no viable alternative to Fannie Mae and Freddie Mac and thus the best solution is recapitalizing and restructuring the entities to make them safer. Such a route is not only the least risky and least disruptive solution, it is also a solution that could result in a huge windfall for the government as it would allow them to sell their 79.9% interest over time as they did with other TARP investments like AIG. According to an October 20th ***Bloomberg Intelligence Report*** by Political Analyst Ben Elliott, "the key takeaway from the Trump Administration's chatter is that it officially intends to privatize the GSE's" and that "Congress may find utility in using Fannie and Freddie as a way to pay for a border wall or other partisan legislative priority. The sale of Fannie and Freddie could generate $100 billion, according to estimates by Moelis." The same Moelis analysis referenced in the ***Bloomberg Intelligence Report*,** estimates the preferred securities of Fannie Mae and Freddie Mac could be worth as much as $25 per share, which would be a gain of nearly 300% from current levels.

As the political path towards a resolution appears to be gaining momentum, the wheels of justice continue to grind (albeit slowly) with several key developments of note as well. On September 28th, U.S. District Judge Royce Lamberth ruled that shareholders could not have known the 2012 Net Worth Sweep was a course the government might pursue based on the terms of the conservatorship when it was established back in 2008. The result of Lamberth's ruling is that shareholders will be able to further pursue their claim that the 2012 Sweep amounted to a "breach of the covenant of good faith and fair dealing." A verdict in favor of plaintiffs on this claim could mean that plaintiffs are entitled to monetary damages, a number which could total in the tens of billions.

In addition to the ruling by Judge Lamberth, in June the Fifth Circuit Court of Appeals ruled that the FHFA, Fannie and Freddie's regulator and conservator, is unconstitutionally structured, given it is unlawfully sheltered from presidential oversight. Failing to vacate the 2012 Net Worth Sweep, the ruling improves the likelihood that the Supreme Court will ultimately hear the case.

Lastly on the legal front, the "illegal taking" case before Judge Margaret Sweeney in the U.S. Court of Federal Claims is likely to be fully briefed early next year with a ruling likely sometime in the first half of 2019. Like the "breach of the covenant of good faith and fair dealing" case before Judge Lamberth, a ruling by Judge Sweeney granting shareholders their day in court would result in a second monetary damages case looming before the government.

With budget deficits bulging and affordable housing shrinking, the Administration has an opportunity for a "Masterpiece of a Deal" that benefits all constituents (taxpayers, homeowners and shareholder rights) and would go down in history with the Louisiana Purchase as one of the greatest of all time. Kicking the can past 2019 could open a legal Pandora's Box, potentially exposing the Administration to hundreds of billions in liability if courts were to award monetary damages to shareholders. Secretary Mnuchin has said 2019 is the year to resolve housing reform. With the political aspects of this investment converging with the legal, we agree. As such, we continue to view the preferred shares of Fannie Mae and Freddie Mac among the most attractive investments in public markets today.

AIG

AIG remains a "show me" story in the turnaround universe and frankly year to date the story has not been good. Last week, the global insurance giant announced that it is likely to suffer catastrophe losses of nearly $2 billion as a result of the typhoons in Japan and the hurricanes that have slammed the U.S. coast in recent months. With reserves of more than $40 billion, the loss is easily manageable and appears more than reflected in the share price given the pullback year to date. On the one hand, shares represent a great value at less than 80% of tangible book value. On the other, they have been at these levels for years as the company has been unable to do the things necessary to realize the inherent value. Management has stated they expect to post a sustainable operating profit by the end of 2018. Doing so would go a long way toward driving out the value inherent in shares. As such, all eyes are on the year end update.

Fairfax Financial

Fairfax is positioned to benefit from rising short term interest rates as over half of its' $40 billion investment portfolio is invested in cash and short-term bonds having maturities less than two years. Further, a return to the historical outperformance of value investing versus growth would likely bode well for Fairfax given the "value roots" of its investment team. Trading for approximately 1.10 times book value, we continue to find the shares undervalued and poised for a multi-year run of strong returns. At the annual meeting we attended last April in Toronto, management indicated it was focused on significantly reducing the number of shares outstanding over the next decade. Year to date, Fairfax has repurchased over 300,000 shares (more than $200 million worth). We expect management to continue repurchasing stock as long as the company remains attractively priced.

Summary

Despite recent frustration, our portfolio investments trade significantly below our estimates of intrinsic value. If history is any guide, the two measures will ultimately converge and we will be rewarded for our patience during this tough stretch. As we wait, we take great comfort knowing our portfolio has a large margin of safety at a time when many of the most popular names driving the markets do not.

Thank you for your steadfastness,

Brian F. Boyle, CFA