16th July 2019

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Anne Farlow (Chairman)
cc Pershing Square Holdings shareholders

Sent by email

Dear Anne,

Reference: https://www.investegate.co.uk/pershing-square-hldg--psh-/bus/pershing-square-holdings--ltd--announces-fully-committed-private-placement-of--400-000-000-4-950--20-year-unsecured-bonds/20190715070000Z2050/

Asset Value Investors (AVI), on behalf of institutional clients, has been a shareholder in Pershing Square Holdings (PSH) for over two years. We own 6.7m shares across our investment funds, representing a 3% stake in the company worth in excess of $120m[1].

We are writing this open letter to you following the outrageous decision by the Board to sanction the issuance of $400m of twenty-year debt without, as far as we are aware, any consultation with shareholders unconnected to the Investment Manager**. The issue of such long-dated debt materially constrains the Board's ability to manage PSH's persistently wide discount to NAV, at a time when doing so should be their primary focus. We are staggered that the Board has decided to further tie its hands in this way.**

At AVI, we pride ourselves on being an engaged shareholder in all our investee companies, and our first preference is always to resolve contentious issues behind closed doors. Indeed, we did so with you in January 2018 when the ill-conceived proposed tender by Bill Ackman was rightly abandoned in favour of a company-led tender following representations from ourselves and other shareholders. With the debt issue being announced as a "fully committed" *fait accompli*, we see no choice other than to write to you in this public forum in the hope that sunlight is the best disinfectant for the company's corporate governance failings.

We had hoped the recent initiation of a buyback program, albeit small, was the start of a new approach from the Board. Unfortunately, this latest announcement more than re-traces that baby step in the right direction. PSH shareholders have suffered from a persistently wide and growing discount to NAV, which is even more remarkable given the company's investment portfolio is comprised of large-cap, liquid, listed securities. A near-30% discount is usually only found on investment companies where the assets are distressed or highly illiquid, where there is some doubt as to the credibility of the valuation, or where the company's structure or constitution gives rise to a mis-alignment of incentives and conflicts of interest.

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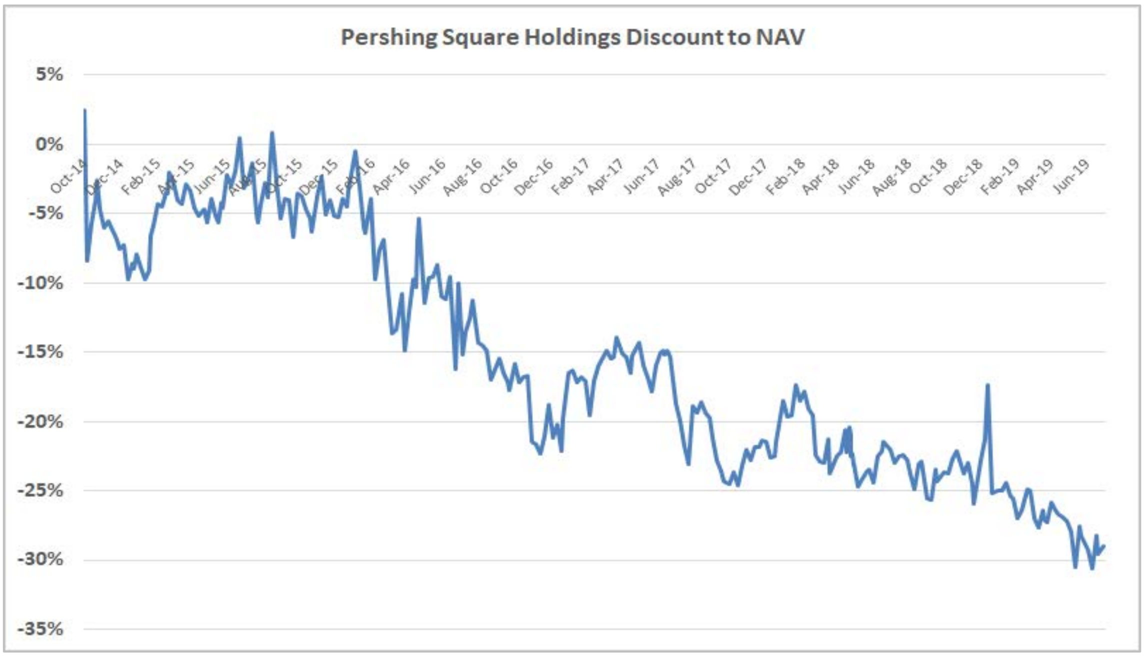
[1] In the spirit of full disclosure, please note that a portion of our position (44% of our total 6.7m shares held) is hedged for risk management purposes.



With the investment management team of PSH owning 20% of the company's shares, and shareholders' voting rights and their ability to requisition meetings limited by both the VoteCo's control of 50.1% of the votes and PSH's sheer size, a strong independent-minded Board is crucial.

However, the independent directors seem entirely acquiescent and prepared to rubber stamp any proposals the Investment Manager puts in front of them; the lack of consultation with shareholders implies either a failure to think through and understand the consequences of this debt issue, or an alarming disregard for shareholders' interests. This steamrolling of shareholders is all too reminiscent of the proposed tender by Bill Ackman in early 2018 referred to earlier in this letter. Our impression then was that the Board failed to see the inherent conflicts of interest and the need to put shareholders' interests first, and were caught on the back foot when shareholders revolted. Sadly, it seems no lessons have been learned.

We make the following points:

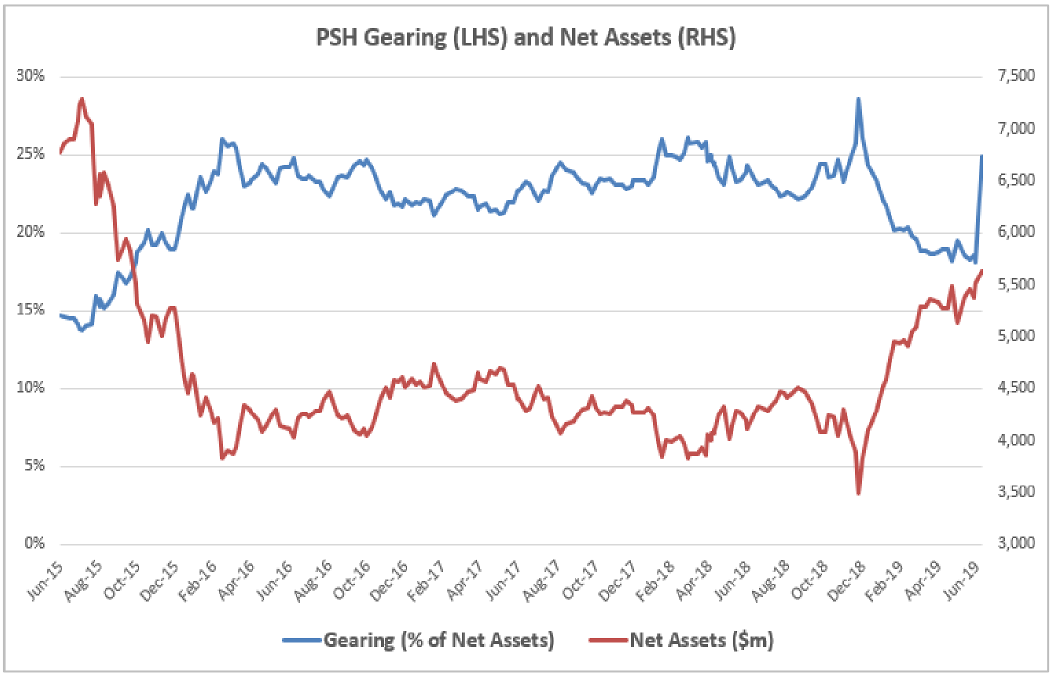
1. While the ability to employ structural leverage is a clear benefit closed-end funds enjoy over their open-ended counterparts, the decision to do so must be weighed against its impact on the company's flexibility to manage its discount through share buybacks.

2. We understand the historically attractive rates available on long-term financing. That said, it seems remarkably presumptuous for the Board to be issuing debt with a twenty-year tenor when shareholders who invested in PSH at IPO have experienced a share price total return of -26% over a period when the S&P 500 has returned +74%. Twenty years is an excessive term given weak historical performance and the astonishingly wide discount, and acts as a quasi-poison pill against more radical action being taken on the discount given the estimated current make-whole premium of 31% that would be payable if this new debt were repaid early[2], equivalent to 2.2% of PSH's NAV.

[2] Assumes the new debt pays semi-annual coupons; also assumes same "make-whole" spread of 50bps over applicable US Treasury yield as per the existing bonds

3. With estimated gearing (debt to net assets) of 18%, we note that PSH was already in the top ten most leveraged funds of the 165 “investible”[3] equity-investing London-listed investment companies[4]. The addition of the private placement notes makes it the fourth most-leveraged fund of this peer group, with its gearing increasing to 25%.

4. As the chart below shows, PSH’s gearing was 15% at the time of its $1bn bond issue in Jun-15. It is unclear to us why the optimal level now seems to be 25% when the discount is far wider than it was then (29% now versus an estimated 2% in Jun-15), and the level of realised volatility in the company’s NAV has been far higher than most shareholders would have reasonably expected.



5. The covenant on the existing bond relating to *Total Indebtedness to Total Capital* specifies a ratio of 1.0 to 3.0 beyond which the company is restricted from paying dividends or repurchasing its shares. As this is equivalent to a gearing ratio of 50%, we concede there is a reasonable distance from the current level.

   However, we note that PSH’s gearing ratio peaked at 29% on 24-Dec-18 on the back of the broad market sell-off. Were this trough NAV to be reached again, gearing would spike up to an uncomfortable 40% given the additional leverage from the private placement notes.

6. Furthermore, the company’s stated desire to maintain an investment grade rating on the existing bonds means that, in practice, the restriction on distributions to shareholders (whether buybacks or dividends) kicks in at a materially lower leverage ratio (Fitch cite a 35% net debt to NAV ratio as the quantitative trigger for a downgrade) than the covenant’s headline figure of 50% would otherwise suggest.

   We estimate that a 23% decline in PSH’s total assets would see the company hit the debt to net assets ratio that Fitch cite as their quantitative trigger for a downgrade - thus a sharp fall in the market could well place the company in a position where its ability to repurchase shares is severely constrained.

[3] Market capitalisation greater than £100m

[4] Data sourced from Numis Investment Companies Datasheet 15-Jul-19; refers to “potential” rather than “effective” gearing

7. We note Bill Ackman's comments in PSH's annual report on buybacks and leverage: "*Buybacks have other drawbacks as they reduce our shareholders' equity and increase our leverage. We would not be surprised to find that a higher leveraged PSH trades at a greater discount to NAV when compared to a less leveraged PSH*".

   Given gearing was at 20% when this report was written[5] and the new debt issue will see this increase to 25%, it seems Bill's aversion to an increasing leverage ratio could more accurately be described as an aversion to shrinking the assets on which management fees are earned.

8. We infer from the new debt issue that the Board sees the optimal gearing ratio as 25%. There is no reason, however, why this could not have been achieved by shrinking the equity base rather than increasing the nominal amount of leverage outstanding. A tender offer for an amount sufficient to bring the ratio up to this 25% level would generate an enormous amount of NAV per share accretion for continuing shareholders. We estimate that a tender of this size, clearing at a 20% discount, would result in a NAV per share increase of +11%[6], far outweighing the 16bps reduction in the average cost of debt achieved by this issuance, which saves just 4bps per annum on NAV.

   This is Capital Allocation 101 and, while we can understand why the Investment Manager would not wish to see fee-paying assets decline, we are at a loss as to why the Board would not prefer this route to achieving the targeted leverage ratio. Did the Board consider this approach?

   We are aware that the Investment Manager's main argument against large-scale returns of capital is that shareholders will profit more from new investments generating returns year-on-year as opposed to one-off gains from share repurchases. Leaving aside the fact that the NAV accretion from share buybacks is certain, immediate, and risk-free, and that not all of the investments made since PSH listed have achieved positive returns, we stress again - as we have in previous correspondence - that the two are not mutually exclusive. There is no reason why a pro-rata amount of each existing holding cannot be sold to fund both a large tender offer *and* new investments.

   As beneficiaries of the improved NAV performance generated by the Investment Manager over the last seven months, we applaud the "back-to-basics" investment approach that has seen the team construct a high-quality investment portfolio with clear idiosyncratic growth drivers. It is entirely fallacious, however, to claim that the continuation of this investment strategy is inconsistent with large share repurchases.

We note the only sell-side analyst to have commented in detail on the new debt issuance shares many of our concerns (emphasis added):

*"The debt will be issued on attractive terms but PSH's current 30% discount entails that **attention will inevitably focus on the implications for discount management.***

*Although there remains plenty of headroom to the indebtedness covenant, **re-levering the fund via additional debt is therefore not a positive from a discount control perspective**. Moreover, the obvious push-back to the issue is that the fund could have re-levered indirectly by returning equity, something that would have appeased shareholders worried about the extent of the discount"*

Matthew Hose, Jefferies, "Pershing Square Holdings (PSH NA, BUY): Long-Term Bond Issue", 15-Jul-19

[5] 25-Mar-19 is the date of the Chairman's Statement
[6] A $1.6bn tender offer would be required to increase leverage up to 25% of net assets; at a 20% discount, this would result in 36% of shares being repurchased, adding +11% to NAV per share

We call upon the independent directors to halt the private placement notes issuance ahead of the scheduled completion date of 25-Jul-19 and embark on a comprehensive consultation with PSH's shareholder base to understand better what is expected of them.

We are confident that a majority of shareholders unconnected to the Investment Manager would be supportive of increasing leverage *via* a more aggressive share repurchase program/tender offer rather than by issuing new debt.

That said, this latest episode has confirmed to us that shareholders would likely benefit from a newly reconstituted Board willing and able to properly defend and represent shareholders' best interests, and take credible action to reduce PSH's huge discount to NAV.

We urge other shareholders who share any of or all our views to make them known to the Board. Shareholders who wish to discuss this letter are also encouraged to contact us at **tom.treanor@assetvalueinvestors.com.**

Yours sincerely,

Tom Treanor
Executive Director/Head of Research