THIRD POINT

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First Quarter 2015 Investor Letter

I founded Third Point on June 1, 1995 with $3.4 million in capital from five intrepid investors – all close friends and family – and my own nest egg. My goals were to compound at 20% and grow to $20 million in assets. Nearly twenty years later, we have been able to meet our initial return goals (despite over-shooting our asset base target) as a result of remarkable individuals who have come together to form our team. The keys to our success have been remaining entrepreneurial, creative, committed to organizational and individual improvement, rigorous about our process, and singularly focused on achieving superior risk-adjusted returns for our investors.

Today, we are finding opportunities primarily in equities in the US and Japan, in sovereign debt, and in structured credit. We added several positions of significant size over the past few months that reflect geographic and sector diversity. We have invested in more single name shorts this year than in all of 2014 combined. Our portfolio performed well in Q1, beating the index by over 2% with a little over half of the value at risk.

So far in 2015, the real excitement has been overseas, while the S&P is close to flat. Accommodative monetary policy in Europe, Japan, and China has encouraged investors to adopt QE pattern recognition and plow capital into markets where central banks have opened pocketbooks. In the US, markets have been mixed as investors await the Fed's looming rate hike and worry about dollar strength impacting earnings and the economy.

We remain constructive on the US for three reasons: 1) economic data should improve in the next few quarters; 2) the Fed does not seem to be in any rush to move early and a June rate hike seems unlikely; and 3) while investors are focused solely on the first rate raise, we think the overall path higher will be gradual, in contrast to previous rate shifts. These factors should create an environment where growth improves and monetary policy stays flexible, which is generally good for equities (higher multiples notwithstanding). We may follow last year's playbook and ignore the old adage to "sell in May and go away."

Quarterly Results

Set forth below are our results through March 31st, 2015:

	Third Point Offshore Fund Ltd.	S&P 500
2015 Year-to-Date Performance*	3.3%	1.0%
Annualized Return Since Inception**	17.2%	7.6%

*Through March 31, 2015. ** Return from inception, December 1996 for TP Offshore Fund Ltd. and S&P 500.

Select Portfolio Positions

Equity Position: Yum Brands

Third Point holds a significant stake in Yum! Brands ("Yum!"), the second largest global quick service restaurant company ("QSR"), whose brands include Kentucky Fried Chicken, Pizza Hut, and Taco Bell. We initiated our position in the first quarter based on our view that the company was in the early stages of turning the page on recent troubles in its Chinese business. We believe this development should neutralize the largest overhang on the stock, set the stage for a dramatic profit recovery over the next 12-24 months, and change the public market narrative around long-term shareholder value-creation for the company.

Over the past two decades, Yum! has built an enviable consumer franchise in China and the company now operates about 7,000 KFC and Pizza Hut restaurants in more than 1,000 cities and has three times as many restaurants as its closest competitor, McDonald's. Approximately 80% of those units are owned and operated by the company and the China division is now the largest earnings contributor to the group, accounting for about 1/3 of overall profits.

Yum! has struggled recently in China due to two supplier-related food safety incidents. The first, in November 2012, involved the level of antibiotics and antivirals used by some of the company's poultry suppliers. The second, in July 2014, concerned the use of expired meat by a different supplier. Food safety is a highly sensitive issue in China and the two incidents, combined with a more dynamic competitive environment, have significantly reduced the company's profitability in China. Today, the average unit in China generates sales of $1.3 million at a 15% restaurant-level operating margin – compared to $1.7 million in sales at a nearly 20% margin before the first food safety incident – and operating profits per unit are down about 40%.

We have spent substantial time assessing Yum!'s recovery potential and examining whether its status as a "repeat offender" has irreparably damaged the brand in China. Our research suggests that the KFC brand (75% of units in China) continues to resonate strongly with local consumers across a variety of important dimensions, including food quality, value, convenience, and customer experience. By an overwhelming majority, local consumers believe the food at KFC is safe or at least as safe as other restaurant options. Perhaps most importantly, local customers continue to visit KFC, albeit less frequently, suggesting the company can increase traffic with better execution. As a rule of thumb in the restaurant industry, it is easier to generate more business from existing customers than it is to capture new ones or win back those who have left the brand.

We have also been encouraged by recent actions that Yum! corporate and local management have taken to stabilize the business and return it to growth. The senior leadership team in the US, led by new CEO Greg Creed, is taking a more active role in Chinese operations, an important departure from previous management's practices. Mr. Creed has visited China with a consumer insights team to review local operating and marketing plans. Senior members of the Chinese leadership team have visited their peers at Taco Bell in California to learn best practices from one of the QSR industry's great success stories. In addition, management has beefed up the local talent bench with key hires, while new menus and marketing plans are rolling out and restaurant labor productivity initiatives are bearing fruit. These efforts seem to be working. Last week's Q1 earnings revealed some early signs of stabilization: comps showed sequential improvement for the first time since the second food safety incident and restaurant margins held up surprisingly well given the decline in sales.

With China stabilizing and on the road to recovery, we see scope for significant earnings growth ahead as profits recover in the near to medium term and exceed prior peak in the long-term as the company opens more restaurants to meet the needs of the expanding Chinese middle class. Management currently sees the potential for more than 20,000 KFC and Pizza Hut restaurants in China, nearly three times as many as today. This "open-ended China growth" story once captivated Yum! investors and we believe it could again, especially since returns on invested capital remain high and there are few more effective ways for investors to bet on Chinese middle class consumers.

While Yum! investors have been focused on the China story, the stock market has fallen in love with the strong cash flows associated with high franchise restaurant systems that have the ability to grow both units and same store sales. That is what Yum! looks like outside China. Management is already taking steps to increase the mix of franchise units from 91% to 95% by 2017. KFC (nearly 50% profits outside China) and Taco Bell (nearly 33% profits) are currently delivering growth while Pizza Hut (only 20%) treads water. We see room for further improvement though, and we are encouraged by signs that the new CEO is focused on narrowing the sizable performance gap that exists between KFC and Pizza Hut and best-in-class chicken and pizza peers, particularly in the important US market.

KFC, for example, only generates average unit sales of $1.2 million globally (we believe it is even less in the US) at a 13% restaurant-level operating margin, compared to chicken-focused QSR peers like Popeyes ($1.6 million average unit sales at 19% margins), Bojangles ($1.8 million at 18% margins) and privately-held Chick-fil-A (an industry leading $3 million despite being open only six days a week!). To help the brand evolve beyond its "bucket of chicken" home meal replacement image, KFC needs to 1) contemporize its menu by, among other things, adding more handheld chicken sandwiches, which are one of the fastest growing items on the American lunch menu, 2) operate across all-day segments (e.g., late night), and 3) improve speed and quality of service.

Pizza Hut has a different challenge. It started as a casual dining concept and then expanded into delivery, but the complexity of doing both – in many cases, out of an old "red roof" location – has the company operating at a competitive disadvantage relative to Domino's in delivery, which is the more important part of the pizza market. Today, Pizza Hut generates average sales of $0.8 million at an 8% restaurant-level operating margin. Domino's, on the other hand, generates about the same level of sales out of its small format delivery units at a much higher 23% margin. Pizza Hut can win on taste but it needs to do better on speed and convenience to become a better alternative for the heavy users that drive the category. Investing in digital and a network of small box delivery models should help.

We think investors should want to own Yum! for its unique open-ended middle-class growth story in China and its strong and growing franchise-led cash flows outside China. We also expect that Yum! management, consistent with their prior public statements, will consider a variety of value-enhancing actions to ensure that the market properly rewards its investors for both compelling earnings streams. Such actions could include more refranchising, more leverage, and perhaps even an alternative ownership structure.

<u>Equity Position: Devon Energy</u>

We recently initiated a position in Devon Energy ("Devon"), an E&P company with a $28 billion market cap. Value is increasingly difficult to find in the E&P sector but Devon stands out by combining limited downside with an underappreciated, valuable asset base that can be unlocked through continued portfolio management and improved operations.

Devon's value proposition is compelling. Subtracting embedded midstream value (and associated debt) and a "non-core" but cash-generative Canadian oil sands asset, investors are creating Devon's domestic E&P business for the value of the company's existing US production. As a lucrative kicker, investors also get Devon's vast "tier 1" acreage positions in the Delaware/Midland basins, Eagleford shale and Cana-Woodford for free. Valuing Devon's acreage alongside companies like CXO, XEC and PXD – where we see significant asset overlap in certain plays – suggests the market is undervaluing Devon's US E&P business by $10-15 billion or $25-35 per share.

We believe the company has significant scope for improvement on operational execution as management begins to focus its capital in fewer, higher return areas. For example, during Devon's 2012 analyst day, the company highlighted resource potential in at least 14 development or exploratory plays. In 2016, nearly 100% of Devon's capital will be dedicated to three high-return areas: the Permian Basin, the Eagleford shale, and the Cana-Woodford. This focus is a welcome self-help, value creation measure.

Devon is also making swift progress in enhancing its operations via improved completion techniques. The company is following the lead of peers in testing increased proppant concentration (pumping more sand in its fracs) and longer laterals with positive early results. As these completion practices move from the testing phase to becoming routine, we expect Devon to close the operational gap with competitors, leading to positive production surprises in the coming quarters.

In portfolio management, Devon has executed on a series of strategic moves over the past five years to improve and simplify its asset base, including: 1) the timely exit in 2010 of its international and domestic deepwater assets; 2) engaging in a pair of joint ventures on its onshore unconventional assets that allowed the Company to avoid significant capital costs on what are now non-commercial assets; 3) the 2014 purchase of GeoSouthern, a "tier 1" asset in the Eagleford shale; 4) a value-creating merger of its midstream assets with a public MLP in 2014, since renamed "EnLink"; and 5) the sale of its non-core conventional assets in both Canada and the US. While some of Devon's recent portfolio moves may have taken longer than investors had hoped, we think the market has begun to appreciate management's willingness and desire to actively shape their portfolio.

To unlock the company's full value, there is more to be done. We encourage Devon's leadership team to build on its track record and continue streamlining its portfolio to focus on top-tier US assets in the Permian Basin, Eagleford, and Cana-Woodford.

Update: Japan

We recently returned from a trip to Japan. We have been following Japan's transformation story closely since Prime Minister Abe was elected on a platform promising dramatic reforms. As we predicted back in 2013, Abenomics is working, with the world's focus now on an element we first highlighted nearly two years ago: corporate governance reform.

In pieces for the Wall Street Journal and the American Enterprise Institute in June 2013, we argued along with our friends Professor Niall Ferguson and Larry Lindsey that for this time to be truly different in Japan, corporate governance reform had to occur.[1] Abe identified corporate governance reform as a key element of his "Third Arrow" and while it took its time hitting its target, it is in full bloom this Spring. We now have nearly 10% of assets invested in Japan.

Our trip confirmed what we had been seeing from half way around the world. In 2014, Japan created an index of 400 domestic companies that employed "best practices" of corporate governance. The jockeying to be part of the index set off conversations about outside directors, transparency, and modernizing investor relations. This has had wide-reaching effects. Last month, Dai-Ichi Life Insurance, one of Japan's largest equity shareholders with over $30 billion invested in domestic equities, announced that it wants companies it is invested in to have outside directors and set RoE and shareholder return targets. They have stated that they will vote against management teams that do not meet these standards. This was a bold move by a domestic investor. If other Japanese insurance companies and asset managers adopt this approach, pressure on Japanese management teams to change behavior will increase further.

Fanuc

In our last letter, we wrote about our investment in Fanuc, one of Japan's best companies. While we believe Fanuc's business is the Apple of Japan in terms of products, vision, and efficiency, the company was hampered by a lack of communication and an inefficient capital structure. Since February, led by its CEO Dr. Inaba, Fanuc has taken important steps. The company has increased transparency, and graciously met with our CEO and team at the company's headquarters in the shadow of Mt. Fuji. This week, Fanuc announced a significant, shareholder-friendly capital return program with three key

[1] The full Wall Street Journal piece is available at:
http://www.wsj.com/articles/SB10001424127887324021104578551213361894312.
The full AEI piece is available at:
http://www.aei.org/wp-content/uploads/2013/06/-the-right-target-for-the-third-arrow_172849809480.pdf.

features: 1) taking its dividend payout from 30% to 60%; 2) cancelling treasury shares to reach a 5% level; and 3) pledging to buy back shares opportunistically, targeting an average annual total return of approximately 80% of net income. Fanuc's stock has responded enthusiastically to these changes.

IHI

While many companies like Fanuc are obeying the Abenomics imperative, some have failed to keep pace with a changing Japan. One such company is IHI, where we invested in 2013 on the basis of the company's compelling franchise in civil aerospace engine technology and vehicular turbochargers. Since our initial investment, the operating profit in IHI's Aerospace & Defense business has increased from ¥15.4 billion (FY 3/13) to over ¥40 billion (FY 3/15) due to the steady rise in demand for spare parts for the V2500 and GE90 engines which power the world's bestselling narrow body and wide body planes. IHI's newer engine platforms GEnx, PW1100, and GE9X are also highly promising and we forecast the division's profit will surpass ¥60 billion soon. Automotive fuel efficiency remains a powerful trend around the world and we believe IHI's turbocharger business will continue to grow and has potential for major margin improvement.

Unfortunately, IHI's various E&C businesses – which we have identified in our meetings with management as a significant source of risk – have been a constant source of losses and distraction. IHI's equity investment and debt guarantee to Atlantico Sul, a Brazilian shipyard working for Petrobras and now considered insolvent, came as a shock to many shareholders and resulted in IHI booking an extraordinary loss of ¥29 billion. The poor performance of IHI's offshore structures and bridge construction businesses have led to a 10% downward revision of management's FY14 operating profit guidance. Additional debt guarantees of over ¥17 billion made to unrelated companies including a flu vaccine manufacturer, a Russian auto parts maker, and a bio-mass power plant in California continue to create an overhang. We expect that at the AGM in June, investors in IHI will demand answers from management about why the company continues to spend shareholder capital so irresponsibly.

Management has had ample time – beginning in 2007 when the company was placed on a watch list by the Tokyo Stock Exchange after reporting large losses from engineering projects – to consider the scope of its portfolio of 40 businesses. Shareholders deserve prompt answers to three key questions: 1) what will portfolio restructuring look like; 2) how does management plan to stop the subsidization of loss making units by the engine technology businesses; and 3) how does the company intend to handle its central Tokyo real estate assets, which we think are worth over 50% of the company's market cap. In today's Japan, it seems inexcusable for IHI to leave these shareholder questions outstanding any longer or for the company to continue with its dilutive and damaging capital allocation practices.

Looking Ahead

Despite our optimism, we have one cause for concern in Japan: several companies we met seemed focused on quick fixes, perhaps hoping that if they act now, the zeal for reform will fade and they can return to their old ways. There is a risk that management teams confuse simply increasing payouts and stock repurchases with the fundamental restructuring of business practices that is necessary to enhance the long-term competitiveness of the Japanese economy. We anticipate the government will continue its efforts to encourage corporate governance reform and companies will evolve and modernize – but in some cases, slowly.

Business Updates

Third Point Quarterly Call and Business Update

Third Point's Q1 2015 Quarterly Call and Business Update was held on April 29th. A replay is available until May 13th. Please contact Investor Relations for details.

Sincerely,

Third Point LLC

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