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First Quarter 2017 Investor Letter

Review and Outlook

During the First Quarter of 2017, volatility declined and most markets rose in anticipation of global reflation. Third Point generated returns across credit and equity strategies and most sectors through successful security selection and portfolio repositioning. New investments during the quarter were initiated primarily in the financials, industrials, and energy sectors.

We expect the favorable environment for our investing style to continue for three reasons: 1) Corporate activity should pick up as President Trump's tax plans are detailed and enacted; 2) Opportunities for activist and constructivist investing are robust; and 3) Combining security selection with a reasonable interpretation of the macro continues to be critical. While we recognize that we are in the late stages of an economic cycle, experience has taught us not to miss the end of an expansive period. This is especially true following Trump's election. Animal spirits matter in markets and despite the obstacles that the new administration will face in passing legislation, the overall pro-business environment is in sharp contrast to the last "you didn't build it" administration's attitude towards business, enterprise, and free markets.

We have been more focused on improving global growth than on the "Trump trade". The Goldman Sachs global GDP forecast for 2017 is +4.2% vs. +2% a year ago. We are seeing more opportunities in Europe because of strong and improving economic data, a trend that will likely continue now that the French elections have passed without incident. Although S&P earnings were flat over the past three years, we are expecting earnings growth to drive gains and cyclical names to get a tailwind from US policy shifts this year.

So what are the risks? While we think legislative failure on tax reform could be negative in the back half of this year, we are encouraged that BAT seems to be off the table. There is a risk of inflation catching the Fed flat-footed, but we see this surfacing later in 2018 or 2019, if at all. Recent dampening of data in the US, particularly in consumer spending, has raised a red flag and we will know more when we see Q1 GDP. Chinese nominal GDP growth has potentially peaked, but the main event there will be the change of government this fall and so we expect a muted status quo until then.

We have actively positioned our portfolio to absorb modest S&P sell-offs in order to remain aggressive buyers at appealing prices. For example, we were able to temporarily reduce over 20% of our equity exposure in advance of the French election at a relatively inexpensive cost of about 20 basis points. We continue to maintain the bulk of our exposure in equities, including in several new initiatives where we believe the environment is ripe to take actions to remedy poor performance.

Quarterly Results

Set forth below are our results through March 31, 2017:

	Third Point Offshore Ltd.	S&P 500
2017 YTD Performance*	5.9%	6.1%
Annualized Return Since Inception**	15.8%	7.8%

*Through March 31, 2017. **Return from inception, December 1996 for TP Offshore and S&P 500.

Equity Investment: Honeywell International Inc. ("Honeywell")

Honeywell is an industrial conglomerate with a $100 billion market capitalization organized into four primary business segments: Aerospace, Home and Building Technologies, Safety and Productivity Solutions, and Performance Materials and Technologies. The company is a key player in an IoT (Internet of Things) world that is becoming more automated, connected, and energy efficient. Honeywell recently named Darius Adamczyk to succeed long-time CEO David Cote. We are pleased by Mr. Adamczyk's appointment based on his track record, initial communications to shareholders, and our personal interactions with him.

During Mr. Cote's tenure, Honeywell shareholders enjoyed an 11.5% annualized return (with dividends reinvested) versus the comparable 7% return of the S&P 500. During this period, Honeywell executed a successful operational turnaround and achieved peer-leading earnings growth and returns on invested capital. Through disciplined capital allocation, such as the recent acquisitions of Elster and Intelligrated, as well the AdvanSix spin off, the portfolio has been gradually upgraded in quality. However, despite the attractive positioning and financial characteristics of Honeywell's assets today, the stock trades at a substantial discount to its industrial peer group.

Mr. Adamczyk has committed to enhancing the company's organic growth profile and is actively evaluating the portfolio with the assistance of the Board of Directors. Third Point believes that a separation of the Aerospace unit via a spin off transaction would result in a sustained increase in shareholder value in excess of $20 billion. Spinning off Aerospace would transform Honeywell into an industrial growth company with a focus on automation and productivity. The large-cap industrial peer group that most closely resembles Honeywell (ex-Aerospace) in terms of profitability, returns on capital, growth characteristics, and end market exposures consists of Emerson Electric, 3M, Fortive, Rockwell Automation, and Illinois Tool Works. This peer group currently trades at an average forward P/E multiple of 23x, a nearly 30% premium to Honeywell's forward P/E multiple of 18x. A more focused Honeywell should match or exceed the multiples of its peer group, especially if management delivers on its commitment to return to free cash flow conversion in excess of 100% by 2018.

It is clear to us, as well as several sell-side analysts, that Aerospace's presence in the portfolio is the chief cause of Honeywell's discounted valuation and that Aerospace would be better off as a stand-alone entity. Its organic growth has lagged its US large-cap aerospace equipment peers and was the main driver behind recent earnings disappointments. An independent Aerospace public entity would be in a better position to invigorate growth by aligning management incentives with long-term value creation and deploying capital to enhance its strategic position. It would also benefit from increased management accountability and a dedicated Board of Directors with relevant industry experience. While some successful new product introductions such as JetWave are encouraging, we are concerned that annual margin improvement has come at the expense of investments to drive growth.

The industrial landscape is rich with examples of corporate separations that have created more focused companies and delivered tremendous shareholder value. Prominent examples include Tyco, Ingersoll-Rand, ITT, and, more recently, Danaher. We believe the case for Aerospace's separation at Honeywell is just as compelling as these precedents.

Equity Investment: UniCredit SpA

The First Quarter of 2017 marked a turning point in both capital and credit in European financials. As the reflation trade has picked up steam, European banks have maintained lower valuations than US banks (0.7x vs. 1.2x book), driven by a lack of confidence in capital and an inadequate clearing mechanism for legacy non-performing loans (NPLs). The ECB recently noted there were still €921 billion of NPLs at significant EU financial institutions *with NPL ratios >3x the level of US and Japanese banks*. However, its guidance on NPLs, released in March, offered a firm but pragmatic approach to accelerate NPL resolutions and Q1 2017 was the second biggest quarter for announced capital issuance in over five years. While at home the opportunity in financials is linked closely to rising rates, banks in Europe offer a different hook: tangible progress on balance sheet clarity.

Third Point recently made an investment in UniCredit SpA, which raised €13 billion in fresh capital in March, the largest rights issue in European financials since 2009. UniCredit is the second largest listed bank in Italy and has a significant presence in Germany and Austria. We invested in their last rights issue in early 2012, similarly taking advantage of significant volatility during the rights period to establish our position.

We view UniCredit's current recapitalization as a definitive clean-up. UniCredit has raised almost two times the capital that was the "consensus" view in mid-2016 and is raising another €6+ billion from selling its stake in Bank Pekao and Pioneer Asset Management. This combination of almost €20 billion of fresh capital puts the bank at ~12.6% pro forma CET1. UniCredit also cleaned up almost half the NPLs in its Non-Core Bank and took significant upfront charges related to its restructuring plan, which will see headcount reduced by 14% and branches reduced by 25%, all by 2019.

We were drawn to UniCredit by its low valuation and the rights issue. We believe in the medium-term story because of its new CEO, Jean Pierre Mustier. Mustier had an over 20 year career at SocGen, where he contributed to building its leading equity derivatives and asset management businesses. He then ran UniCredit's Corporate and Investment Bank from 2011 – 2015, where it was consistently one of the financial industry's most efficient businesses on a cost/income basis (<45%). While UniCredit shares have appreciated since the rights issue, we still see significant upside for UniCredit with shares trading at just 0.65x tangible book, <9.0x our 2018E EPS estimate and <7.5x our 2019E estimate. These forecasts exclude additional potential upside from rising interest rates or better asset quality, despite the significant progress on NPL resolutions and property transactions we have seen in recent quarters.

Equity Investment: E.On

Third Point invested in German utility operator E.On during the First Quarter. Following a spin-off of its generation assets into Uniper last year, the company has emerged as a regulated grids and renewables business that is currently misunderstood by the market and attractively priced. The German government's policy of "energy transition" caused the precipitous buildout of renewables, forced nuclear plant shutdowns, and a number of poor capital allocation decisions that led to an 80% decline in E.On's market capitalization over the last decade. In our view, the worst is in the rear view mirror.

First, the German government has agreed to set up a state-administered fund to finance the storage of radioactive waste from decommissioned nuclear plants. E.On's portion of the payment into this "nuclear bad bank", which is scheduled for July 1, 2017, is approximately €10 billion, including a risk surcharge to cover the contingency that costs exceed current provisions. While this has temporarily pressured E.On's balance sheet, we believe it will result in imminent, significant, and permanent reduction of the company's risk profile.

Although investors remain singularly focused on E.On's weak balance sheet, we believe there are multiple and significant sources of capital from sales of non-core activities that will deleverage E.On's balance sheet over the next 12 months. When financial leverage is reduced, management has signaled its intent to increase the dividend payout ratio to an industry norm of 70%+, implying annual dividend growth in the low-teens range over the next few years.

E.On's renewables portfolio is comprised of regulated vertically integrated on- and off-shore wind parks with planned expansion opportunities at relatively high regulated rates of return on equity. Recent transactions suggest that E.On could monetize its wind portfolio at very attractive valuations given the interest in such assets from investors with low costs of capital.

Management is focused on cost cutting by addressing E.On's lagging labor productivity, which is an outlier in the industry. A €400 million efficiency program is in place but our benchmarking analysis suggests management could pursue much more ambitious targets in order to right size the business for its reduced footprint.

E.On's core electricity and gas distribution grids are exceptionally valuable as they cannot be replicated. Furthermore, they are now set for decades of profitable growth. We like utilities that operate in benign regulatory environments where the regulator has a clear objective to stimulate investment and guarantee attractive returns. To achieve its ambitious plans of full decarbonization by 2050, Germany will have to encourage significant investments in its power distribution network such as grid digitalization, EV charging stations, smart meters, and large-scale storage stations that allow a much greater portion of peak demand to be covered by renewables. Recent purchases of comparable assets have highlighted E.On's mispricing. In 2015, Finish utility Fortum sold its Swedish electricity distribution business to a consortium of pension funds for 16.6x EBITDA. Last month, Portuguese utility EDP agreed to sell its Spanish gas distribution network Naturgas to a consortium of sovereign wealth funds and life insurers for 15.9x EBITDA. E.On trades at less than 8x EV/EBITDA.

Equity Position: FRAC Sand Miners

Is sand the new gold? In early Q1, the combined market capitalization of frac sand miners had reached $11 billion, pricing in an average Enterprise Value per ton of over $300 or over 15x replacement value. An army of consultants, sell-side analysts, and speculators were confidently pointing to the exponential rise in demand for frac sand as rig counts and company budgets turned a corner, drilling activity was on the upswing, and proppant intensity was rising. The frac sand industry's cheerleaders were certain they could continue to outwit the laws of supply and demand.

Our field work identified an important shift from the use of northern white to abundant in-basin brown sand. In addition to a large and growing number of greenfield projects that are creating new capacity, we uncovered significant overhang that has been sitting on the sidelines and is now being reactivated.

As sand pricing starts to decline in summer or fall at the latest as a consequence of the outsized supply we have seen, we expect many of the publicly-listed frac sand miners to end up with little if any equity value.

Sincerely,

Third Point LLC

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