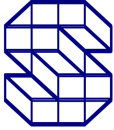

Steinberg Asset Management, LLC

Second Quarter 2016 Commentary and Outlook

Major stock indices ended the quarter near all-time highs as equities shook off Brexit shocks and rode a reflation-sponsored rally courtesy of the world's major central banks. The stock market advance has been buoyed by central banks' signals, sent earlier this year, that monetary policies would not undermine global growth. While the U.K. vote to exit the European Union triggered a selloff in equities causing share prices to fall more than 5% in just a few days, the decline was short lived in light of the expressed commitment of policy makers to use fiscal and monetary tools to help prevent events in Europe from depressing global growth.

In the near term, U.S. equity markets should continue to benefit from historically low interest rates, and the relative attraction of our financial markets for global capital. However, as equities are not particularly cheap, occasions of volatility may be amplified whether triggered by Brexit issues, disappointing corporate earnings, fears of a hard landing in China or a strengthening U.S. dollar.

A Threat to Long Term Growth

The U.K. referendum served as a wake-up call to governments around the world that they can no longer ignore trends of stagnating wages and unbalanced distributions of wealth that have intensified since the global financial crisis. The problem is manifest in weak growth in median family incomes in many countries. This income/wealth disparity is swinging attitudes in developed Western economies against free trade. The rise of populist economic nationalism threatens to impose a hostile environment for business and carries a significant threat to long-term economic growth by creating headwinds to capital investment at a time when the trend in productivity is not favorable.

The best way to address the root cause of populism is by achieving stronger economic growth leading to broad-based increases in demand for labor and higher wages. Therefore, in the next few years policy responses addressing this issue will have an important influence on global economic growth, social cohesion and financial markets stability.

A Challenge to Global Peace and Prosperity

Voters in the U.K., long a semi-detached member of the EU, have chosen to leave the union, opting to endure short-term economic pain in favor of the hoped-for benefits of independence over the longer term. Among the many unanswered questions about Britain's exit, the key one is whether Brexit will amount to an isolated incident or the beginning of the end of the union, the Euro currency and the continent's open borders. These essential elements of the modern EU have played an important role in enhancing geopolitical stability and fostering global economic prosperity.

An unwinding of the EU would not bode well for long-term global stability or economic well-being, and an increasingly multi-polar world would point to an elevated challenge for maintaining a peaceful world order. Moreover, economic prosperity would suffer if flows of goods and

12 East 49th Street, New York, NY 10017 212-980-0080 Fax 212-980-8890 www.samny.com

services became more restricted. Finally, an unwinding of the EU would be accompanied by dislocations in the financial system and markets.

However, the dissolution of the EU can be avoided. Making the Eurozone prosperous is critical to avoiding its break up. Economic regulation, immigration policy and global geopolitics are all playing roles in the rising Euro-skepticism that is eroding the union. Nonetheless, if the populist movement is to be reversed and the union is to survive then the European political and economic establishment must develop and successfully implement a practical plan that will produce widely shared economic growth. Having Germany prosper while France languishes and Spain and Italy suffer is not a formula for success.

New Strains of Populism at Home

Here in the U.S., the current presidential election process points to a shift in our political landscape, one that offers parallels to some of the more counterproductive trends in Europe. The political consensus that has existed for the better part of the last three decades in favor of free trade and deregulation is at risk of being supplanted by a new political order less friendly to business and economic growth. Such a development would be self-defeating because it would sustain slower growth, exacerbating the core problem of income and wealth disparity.

With the limits of monetary policy to stimulate the economy having been reached, fiscal policy will be required to play a central role in meeting our desired national objectives, regardless of the election's outcome. There are reasons to believe our nation's leaders recognize the linkage between economic prosperity and social cohesion, and as a consequence the next administration is likely to work more effectively with Congress to develop a plan to elevate growth and create jobs that pay well.

Infrastructure Bank and Training

Obviously the details of what any fiscal program will look like are not clear at this time. What is clear is that the scale of the initiative must be bold to achieve the necessary results. One solution may be the creation of an infrastructure bank. This has high potential to be effective and would also carry the broad political appeal necessary to ensure it would be more than a pipe dream.

- The infrastructure bank could be funded by a 10% tax on the repatriated earnings of U.S. multi-national corporations, which compares favorably to the current statuary rate of 35% and might be an elegant solution to what has been a contentious issue.
- There is over $2 trillion and growing of corporate capital estimated to be held abroad. If just half of these funds were repatriated the tax would generate revenues of $100 billion, providing the equity for the infrastructure bank. This equity could then be levered around seven times for an initial funding of $800 billion. That is equal to 4% of what will be a $20 trillion economy and could be used to fund qualified infrastructure projects (no bridges to nowhere) from roads and highways to bridges, airports, ports and railways.
- This type of program would increase economic activity and create jobs paying well over minimum wage. The program could be coupled with technical school training at the local level with programs designed to match skill sets to the requirements of local projects.
- By stimulating economic growth and bringing people into the work force at an attractive wage, this type of program could begin to address the core issues that are pulling at our social fabric.

This type of program has been given active consideration by both parties. Such a program would understandably be well received by equity markets although it is not fixed income friendly.

Portfolio Update

During periods of unusually high volatility and uncertainty we are ballasted by our in-depth fundamental research and by our conviction that volatility is not synonymous with risk to the long-term investor. We focus on separating share price gyrations from our understanding of the business and the development of its underlying value for the long-term benefit of our clients.

During the quarter, stocks that comprised a large proportion of our portfolio were down to varying degrees and for discrete reasons while the market was up. This is hardly a cause for celebration, but what is important to us is that the underlying value in these large positions not only remains intact but continues to grow. Of equal importance, there are specific upcoming events that we can clearly identify which will unlock that value. Finally, it is worth noting that these businesses are run by management teams that have a demonstrated record of creating significant long-term value for shareholders. For example:

- Allergan, a leading pharmaceutical company which owns exceptional drug franchises including Botox and a strong pipeline of branded drugs, declined significantly in the quarter when a proposed merger with Pfizer was scuttled as a result of changes in U.S. tax policy. While we saw the opportunity for meaningful value creation had the deal gone through, our investment was not predicated on its completion. Allergan has sold its generic drug business to Teva. That deal is expected to close in the coming days. Upon receipt of the proceeds from this sale Allergan will have no net debt and will have capacity to raise as much $30 billion of debt ($70 per/share of debt, 3x net debt to EBITDA) for repurchases or accretive acquisitions. In fact, the company has already committed to repurchasing $10 billion of stock upon the closing of the Teva deal. At the current market price this amounts to roughly 10% of outstanding shares. Using conservative assumptions, EPS in 2018 should rise to $25-to-$30 from around $14.25 in 2016. Moreover, the company will generate approximately $20 per/share of free cash flow per annum beginning in 2017 so that the company can rapidly de-lever and continue to make acquisitions or execute large share repurchases.

- As we write this letter, Golar, the world's leading independent midstream LNG company, has announced the finalization of its joint venture with Schlumberger. We view this agreement as an extremely positive development as we expect the partnership with Schlumberger to expedite and improve the prospects for completion of new floating liquefaction (FLNG) projects. This view is supported by Schlumberger's CEO who made the following statement in May of this year, "Over the past year, we have worked closely with Golar LNG to understand and assess their FLNG technology, and we are convinced that their offering combined with our reservoir, well, and production system knowledge represents a compelling offering to address the stranded gas market globally… This new and completely integrated approach will reduce risk, reduce costs, and accelerate time to monetize stranded gas reserves and hence **totally transform the economic viability of many stranded gas projects.**" The subsequent announcement of the finalized JV agreement noted that the parties are "confident it would conclude five projects within the next five years." We expect this assessment may prove conservative, but even on the basis of the completion of five FLNG projects over the next five years shares could be expected to trade closer to $100 per share as compared to the current $17 share price. It is worth noting that the stock was down during the quarter on concerns that Schlumberger's withdrawal from a previously announced project meant the JV agreement was imperiled. These concerns were clearly unfounded.

  In addition to progress with Schlumberger, the company's first FLNG vessel (which sits outside the new JV) will be operational in the first half of 2017. We expect this to be a meaningful catalyst. Finally, we expect the year will end with more agreements for highly

profitable projects. All in all, the value proposition for Golar continues to develop. As a result of these recent and upcoming developments we have never been more confident in the company's ability to generate exceptional returns for patient investors.

- Hudson's Bay is a leading high-end retailer with banners including Saks, Lord & Taylor and the Hudson's Bay Company. The company owns a real estate portfolio comprising trophy assets in urban areas across North America (for example Saks Fifth Avenue, on 5th Avenue). Disappointing same-store sales reports and guidance from competitors like Macy's and Nordstrom's led to a large decline in the valuation multiples for brick and mortar retailers. Hudson's Bay faced similar challenges in the quarter but reported industry leading comparable sales.

  The recent challenging period for brick and mortar retailers brought to the fore longstanding questions about the future of retail. While there can be no question that the nature of retailing is evolving with changing consumer behavior related to on-line shopping; we own Hudson's Bay because we can make an excellent investment return based simply on our assessment of the large real estate value. Recent equity investments and appraisals, not simply our estimates, show Hudson Bay's real estate portfolio to be worth around $27/share with the stock trading at $12.50. The majority of this value lies in two real estate joint ventures that are explicitly positioned to be monetized in the years ahead. In the interim the company will continue to diversify and grow its real estate portfolio while upgrading the existing asset base. This will increase the value of both the retail business and the real estate. For example, the company is investing $250 million in the Saks flagship store on 5th Avenue. The stock may rise and fall with the vagaries of the new world of retail but we gain comfort that even if every sweater ever made is bought from Amazon we will happily own world-class real estate properties in the world's greatest cities, and have a visible path to value realization.

Firm Update

As you may recall, entering 2016 we were keenly focused on making improvements to the business. In short, we have and will continue to invest in our research team while finding ways to be more effective and efficient across the business. For example, we are exploring a migration of our servers to the cloud, which will dramatically decrease the resources required for infrastructure upkeep without impacting business continuity and redundancy. There are many efforts like this that will improve our business for the ultimate benefit of our clients.

We hope you and your families enjoy the remainder of the summer and as always should you have thoughts or questions please don't hesitate to reach out to us.

Sincerely,

Michael A. Steinberg
Managing Partner

This letter is confidential and is not for further distribution.

This letter is for informational purposes only and should not be deemed as investment advice or as a recommendation to purchase and/or sell any individual securities discussed in this report. Past performance is no guarantee of future returns. All investing involves risk including the possible loss of principal.

The opinions, forecasts, assumptions, estimates, and commentary contained in this report are based on information provided to Steinberg on both a formal and informal basis which Steinberg believes to be reliable. However, Steinberg cannot represent or warrant their accuracy. The impact on Steinberg's opinions, forecasts, assumptions, estimates, and commentary due to inaccurate information, incomplete information or information taken out of context may be substantial. Further, all opinions, forecasts, assumptions, estimates, and commentary in this report are made only as of the date indicated and are subject to change at any time without prior notice.

Discussions and calculations regarding potential future events and their potential impact are based solely on historic information and Steinberg's estimates and/or opinions, and are provided for illustrative purposes only. No guarantee can be made of the occurrence of such events or the actual impact such events would have on the performance of the companies described in this report.

The securities discussed in this letter are current holdings of Steinberg clients. The reader should not assume that investments in the securities identified were or will be profitable and it should not be assumed that recommendations made in the future will be profitable. There can be no assurance that Steinberg will continue to hold the same position, or any position, in the companies described in this letter in the future. Positions reflected in this letter do not represent all the positions held, purchased, or sold, and in the aggregate, the information may represent a small percentage of activity or holdings in client portfolios. The information presented is intended to provide insight into Steinberg's investment process and certain noteworthy events, in the sole opinion of Steinberg, affecting client portfolios.

.