

## Third Quarter 2022 Investor Letter

October 18, 2022

Dear Investor:

During the Third Quarter, Third Point returned -3.2% in the flagship Offshore Fund.

	Q3 *	YTD *	ANNUALIZED RETURN†
THIRD POINT OFFSHORE FUND, LTD.	-3.2%	-22.7%	13.4%
CS HF EVENT-DRIVEN INDEX	1.8%	-6.0%	6.7%
S&P 500 INDEX (TR)	-4.9%	-23.9%	8.2%
MSCI WORLD INDEX (TR)	-6.1%	-25.1%	6.6%

\* Through September 30, 2022. Please note there is a one-month lag in performance reflected for the CS HF Event-Driven Index compared to Third Point Offshore Fund, Ltd., the S&P 500 Index and the MSCI World Index.

† Annualized Return from inception (December 1996 for TP Offshore and quoted indices).

The top five winners for the quarter were Pacific Gas and Electric Co., Ventyx Biosciences, Inc., Cano Health, Inc., SentinelOne Inc, and Short A.<sup>1</sup> The top five losers for the quarter were Colgate-Palmolive Co., The Walt Disney Co., Short B, Private A, and Ferguson PLC.

### **Portfolio Review and Outlook**

During the Third Quarter, we focused primarily on preserving capital and lost about 3% versus a 5-6% loss in the S&P and MSCI global indices. Fundamentals took a backseat to macro analysis and technical flows. After July's ebullient "bear market rally" sparked by promising signs of inflation reduction, rate containment, and hopes of a soft landing, the mood in August and September became increasingly dour. This has continued into the beginning of Q4, characterized by the incompetence of the new UK government's handling of its own monetary and fiscal policy (punctuated by the defenestration of its newly

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<sup>1</sup> Our ABS interest rate hedging program, in aggregate, would have constituted a top five contributor on the quarter.

appointed finance minister), which unhelpfully introduced a new narrative of concern around “financial stability” that magnified an already gloomy scenario. Most trusted pundits have put forth cogent pessimistic arguments and joined the negative chorus of perma-bear Nouriel Roubini with declarations that we are entering a severe recession and prolonged bear market. The mood at the few hedge fund events I have attended is similarly bleak, with participants laying out their scenarios for potential financial collapse, supported by a competition to come up with the lowest PE multiple of a lowered S&P earnings forecast. Their bleak outlook is reflected in data provided by prime brokers showing historically low nets and grosses in the hedge fund community.

I am sympathetic to many of these economic and geopolitical concerns but, amidst all the gloom, we are seeing very attractive valuations, particularly assuming an economic scenario short of financial Armageddon, and are taking up exposures as we speak. As my friend and mentor, who I will dub the “smartest man in America,”<sup>2</sup> recently told me, he did not know when the market would bottom, but he knew for sure it would be when economic data looked godawful. I am reminded of this NY Post cover and headline from March 9, 2009: “*Warren Buffet: The Economy Has Fallen Off a Cliff!*” I am familiar with this doom spiral trap because I fell into it too, declaring in an investor letter on March 10, 2009 that we should “[brace for impact](#)” just before markets (and our portfolio, since I changed my view only days later based on new data and had ramped exposures to banks/autos) turned around dramatically. The essential question for me at this point is whether capitulation on rates and inflation driven by Fed policy are the key or if a bottom in the real economy (based on unemployment, income, industrial spending and broad measures of GDP) is actually what matters most.

For now, while we remain respectful of the numerous well-flagged risks, we are looking to deploy capital into both world-class companies trading at bargain basement prices and event driven situations that will be somewhat protected from market moves. Should the economy

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<sup>2</sup> Byron Wein, the noted Blackstone market strategist, often quoted his good friend the “Smartest Man in Europe” (later revealed to be Edgar de Picciotto) who he consulted for insights during tumultuous times. I am blessed to have a mentor and friend well into his ninth decade who I also turn to for brilliant perspective during tumultuous times.

deteriorate further, and the recession hit hard, we have short positions and market hedges to dampen the blow as we wait with open arms for opportunities that would emerge in credit, as we discuss below.

	Gross QTD P&L			Gross YTD P&L		
	Long	Short	Net	Long	Short	Net
Equity	-0.5%	-1.7%	-2.3%	-25.6%	7.4%	-18.2%
Corporate Credit	-0.7%	0.0%	-0.7%	-2.2%	0.6%	-1.6%
Structured Credit	0.7%	-0.2%	0.5%	-1.4%	-0.1%	-1.5%
Privates	-0.3%	0.0%	-0.3%	-1.9%	0.0%	-1.9%
Macro/Other	0.1%	-0.1%	0.1%	1.4%	0.5%	1.9%
Total Portfolio	-0.7%	-2.0%	-2.7%	-29.6%	8.3%	-21.3%

### Equity Investment: Colgate-Palmolive

Third Point recently acquired a significant position in Colgate-Palmolive. The investment fits several important criteria in the current investment environment. First, the business is defensive and has significant pricing power in inflationary conditions. Second, there is meaningful hidden value in the company's Hill's Pet Nutrition business, which we believe would command a premium multiple if separated from Colgate's consumer assets. Third, there is a favorable industry backdrop in consumer health, with new entrants via spin-offs and potential for consolidation. Finally, the current valuation is attractive both because earnings growth is poised to inflect higher, and because shareholders are paying very little for the optionality around Hill's or Colgate's ability to participate in further consolidation in the consumer health sector.

Colgate has a strong portfolio of brands and operates across four categories that should perform well across most economic conditions: oral care, home care, personal care, and pet nutrition. Although Colgate has delivered organic sales growth of 5-6% over the past few years, earnings growth has been disappointing, and the stock has become a perennial

underperformer. Foreign exchange headwinds have pressured reported results. Business reinvestment, supply chain disruption, and inflationary pressures have weighed heavily on margins; those headwinds are now reversing. Stepped up investments in demand generation, product innovation, and digital capabilities are starting to pay off. Global supply chain bottlenecks are easing and product availability on the shelf is improving. And, most importantly, raw material, transportation, and wage pressures are stabilizing, and even reversing in some areas, at the same time additional pricing takes effect. Taken together, the stage is set for Colgate to deliver several years of outsized earnings growth, as sales continue to increase, foreign exchange movements are annualized, and margins finally recover.

The star of Colgate's portfolio over the past few years has unquestionably been the Hill's Pet Nutrition business. Hill's is a premium pet food brand that distributes primarily through specialty and veterinarian channels. Its best-known brands are Hill's Science Diet and Hill's Prescription Diet. Hill's has been growing sales organically at 11-12% over the last several years, generates mid/high 20's operating margins, and is on track to contribute about 20% of Colgate's sales and profits in 2022. What is even more impressive is that the business has achieved this level of performance despite experiencing supply constraints. To support future growth, the company recently acquired three pet food manufacturing plants from a third party. This strategic move allows the company to bring on additional capacity faster than rivals, take share and thus accelerate growth.

The pet category is one of the most exciting pockets in consumer, and Hill's is a phenomenal brand with a long runway for growth. We believe that as a stand-alone business, Hill's could deliver even faster growth and better margins, and would command a premium multiple of 25-30x EPS for an aggregate valuation approaching \$20 billion on CY23 numbers. Hill's is a valuable consumer growth company and hidden gem inside of Colgate's otherwise defensive product portfolio.

Colgate is an important piece of the consumer health sector, which is currently undergoing unprecedented change. GSK and Pfizer recently separated their consumer health division (now called Haleon) after rebuffing a GBP 50 billion offer for that business from Unilever.

Interestingly, Haleon has a large presence in oral care, with brands like Sensodyne, Parodontax, and Polident. Johnson & Johnson also plans to separate its consumer health business, which includes marquee brands like Listerine, Tylenol, and Neutrogena. Such large transactions should cause further consolidation in the space, which could create some interesting opportunities for Colgate's assets. Although the Board is fairly long-tenured and not known for making bold moves, we are confident that it will act in the best interests of shareholders if Colgate becomes part of the current M&A minuet in consumer health.

Colgate's valuation provides a strong margin of safety coupled with significant upside. On our numbers, shares now trade for a low 20x multiple on CY23 EPS. Looking ahead, we see shares compounding at a mid to high teens rate over the next several years just from earnings growth and the nearly 3% dividend. Any strategic actions around Hill's or the consumer health sector could add materially to our expected return.

### **Equity Update: Disney**

As disclosed in our Q2 letter, we reinitiated a significant position in The Walt Disney Company when the company retested its Covid lows earlier this year. At the current price, Disney is trading for little more than the stand-alone value of its Parks business and a mere 15x '24 "street" consensus. The company remains early in its Direct to Consumer ("DTC") transition with a leading market position, and yet the current stock price ascribes negligible value to the streaming business. We believe this is due to questions around the terminal economics of streaming, given large losses being generated today at Disney (>\$1 billion dollars last quarter) and stagnating margins at peers such as Netflix. On the last earnings call, management highlighted three items that could lead to an inflection in DTC profitability over the next 12 months: a 38% price increase for Disney+ in the US; moderating growth in cash content expense; and an advertising tier for Disney+ launching in two months that can drive additional ARPU given high demand for the Disney brand amongst advertisers.

While the company has guided to Disney+ achieving breakeven sometime within the fiscal year ending September 2024, the valuation suggests the market remains skeptical. Disney only trades at ~14x the \$7 in earnings generated prior to the Fox acquisition, which implies

investors don't expect earnings to meaningfully exceed this figure in the coming years. Hence, the first value driver we highlighted in our last letter is the opportunity for management to optimize Disney's cost base to drive earnings growth. We believe Disney has ample means to rationalize costs across its operating platform and deliver targeted content for home viewing that does not entail the same cost structure of exclusive theatrical releases.

We have come to agree with Disney's management team that ESPN belongs with the Company at this time. The cash flow from ESPN funds the streaming losses and supports the balance sheet ahead of the Hulu purchase. In exchange, the scale and diversification of Disney provides aircover for ESPN to experiment through the initial phases of its inevitable "unbundling" from linear to DTC. Projecting a brief three years forward, this backdrop looks very different; in 2025 Disney's streaming business will be profitable, Hulu will be fully consolidated, and the pay-TV ecosystem will have ~20% fewer subscribers.

DIS shares currently reflect very little value from ESPN. As the best brand in sports, ESPN is well-positioned to become the leading end-to-end DTC distributor of sports content in the US. This upcoming transition is obviously complicated by the asset's current success; today, ESPN enjoys ~\$11 per subscriber in monthly linear affiliate fees across a base of over 70 million households. To replicate these economics in a DTC world, ESPN will have to successfully integrate a multitude of value-added services such as sports betting, targeted advertising, fantasy football-type services, and merchandise.

Finally, as our joint press release with Disney at the end of last month outlined, we have signed a support agreement and are pleased that the Company appointed a new Board member, Carolyn Everson, who will contribute expertise in ad sales, media, and digital technology that will round out the Board's skills. We look forward to continuing our productive dialogue with Disney's management team.

### **Position Update: PCG**

Since we wrote about PG&E in May, the Company has continued to close the valuation gap with its regulated peer group. Over the third quarter PCG's stock rose 25% versus a 6%

decline in the XLU (a proxy for the S&P 500 Utilities Sector). Outperformance was driven by the S&P 500 indexing announcement and continued execution by Patti Poppe, the recently hired CEO, and her team. Management has focused its efforts on mitigating physical and financial risk by building in layers of protection against catastrophic wildfires, financial uncertainty, and rate-payer volatility. Importantly for a utility company, Ms. Poppe has a plan to make much needed investments in safety, reliability, and service quality via capital investment while simultaneously reducing operating expenses.

Despite the recent move, we are optimistic about the Company's prospects with industry leading 10% EPS growth and likely dividend reinstatement in 2023. PG&E, which currently trades at a 6x discount to peers on '23 earnings, should continue to re-rate as investors become more familiar with the enhanced regulatory framework under AB1054 and build further confidence in management's execution capabilities.

### **Corporate Credit Update**

Our corporate credit book was down -5.3% for the quarter and contributed -65 bps to the overall performance of the fund. Our largest losses were the result of exposure to long duration investment grade situations where we were underhedged, and a distressed investment where the improving underlying fundamentals were overwhelmed by a poor market technical and declining comparable valuations. These were both primarily errors in hedging, which we do not expect to repeat.

While we do not anticipate a quick rebound in either rates or spreads, we find the current opportunity set in high yield credit attractive. A little simple bond math can illustrate the value proposition. At September 30, the Bloomberg High Yield Index had a yield to worst of 9.68%, a spread of +552 and a duration of 4.1. Thanks to the current yield and accretion of bond discount (AKA "pull to par") you would break even owning the index over a one-year horizon even if that yield rises to 12.4%, which would imply a spread of +835 bps. For context, spreads peaked at +800 in 2011 and +600 in 2015. We do expect an increase in defaults as the economy slows but not one that would justify those spreads. We may see an overshoot +1000 but spreads have never been sustained at those levels. Longer term, over a

two-year horizon, an investor still breaks even if the index yield rises to 16.9% and spread to +1284. In the last 30 years this index only touched +1000 bps during 2002 and traded through it during the GFC.

The SPDR Bloomberg High Yield Bond ETF (JNK) has returned -16.2% YTD, on track for one its worst years in history, but we have seen little “forced selling” because the market has been supported by upgrades and a dearth of new issues, resulting in negative supply. We anticipate that net supply will shift to positive through an increase in downgrades as the economy slows, creating the technical pressure that has thus far been missing from this sell off. The new issue market will likely remain light as issuers adjust to new levels, however, there will be supply from issuers that have no choice, creating attractive entry points. As a result, we have increased the intensity of our dialogue with syndicate desks. We look forward to opportunistically increasing our exposure as volatility accelerates.

### **Structured Credit Update**

During the Third Quarter, our structured credit strategy returned 1.3%, with outperformance (as a result of rates hedges) in August and September despite dramatic moves in both rate and credit spreads. Like virtually all other markets, the Fed’s efforts to combat inflation brought the same unease and volatility to the structured credit markets. Despite the increased uncertainty, fundamental performance in asset backed securities has been resilient. Our current yield in the structured credit portfolio is in the high teens, accounting for recessionary loss scenarios.

Our strategy this year has been informed by three key areas of focus:

1. Reducing first-loss tranches where the fundamentals are still outperforming and reinvesting into senior tranches with more credit support and higher current yields. We have increased our senior bond exposure from 20% to 45% this year. At prevailing yields, these bonds offer a much more attractive and stable total risk-adjusted return when we apply recessionary loss scenarios. Year-to-date, we have net sold roughly \$500 million of first-loss paper, with a majority of those positions producing positive IRR from inception despite the widening market. We have



retained our less levered positions, including our RPL mortgage book that has benefited from the prior increase in home prices and continues to outperform expectations. This reorientation has created a portfolio that is more resilient in the face of any credit headwinds we may face in the coming months, while still delivering outstanding returns.

2. Focusing on loans backed by collateral. About half of our exposure is backed by residential housing where borrowers have significant equity in their homes. In addition, we have been constructive on auto loans given the improved loan-to-value of seasoned loans. We are running GFC type losses on our consumer assets and with the move higher in the capital structure, our investments can produce a mid-teens return due to better capital structures and more credit support.
3. Keeping duration short. Our structured credit portfolio duration is around 3 years and is currently amortizing. The current cash enables us to reinvest across credit where we see compelling opportunities.

As the Fed continues its policy of higher rates, we could see more mark-to-market volatility with wider credit spreads, but the currently amortizing nature of structured credit enables us to continually invest in higher yields. While we have seen some weakness in lower-income consumer unsecured and subprime auto loans in our broader data set, delinquencies and defaults in portfolio positions continue to be low, while asset inflation has decreased the leverage of our exposure. Overall, we are seeing some of the most lucrative investing opportunities in structured credit since the Covid-19 crisis, in an environment friendly to our experience of trading between loans and securities to identify the most compelling point of arbitrage.

### **Private to Public Investment Update: Ventyx**

Ventyx is a biotechnology company focused on treating auto-immune diseases by discovering and developing next-generation small molecule drugs for well-validated targets. Third Point first invested in Ventyx in 2016 as an investment in Opillan, which was developing an oral small molecule for ulcerative colitis as a Series B, with a post-money

valuation of ~\$20 million. The company's objective throughout has been to create oral pills with the same efficacy as biologic drugs for significant auto-immune disorders.

In early 2021, Third Point, along with management, agreed to merge our Opillan investment into Ventyx to consolidate all auto-immune disorder assets run by the same management team under one company. We found the consolidated R&D pipeline, especially Ventyx's Tyk2 inhibitor, commercially very attractive. Additionally, the merger allowed the company to bulk up its R&D pipeline and realize R&D synergy across several assets in discovery stages.

The company went public in late 2021 and, in 2022, two events doubled Ventyx share price. First, Ventyx presented human data for their Tyk2 inhibitor, which demonstrated a superior potential drug profile versus Bristol Myer's drug (deucravacitinib). Bristol Myer's drug was approved last month by the FDA with a clean safety label as per the clinical trial results, which increases potential peak sales for this class of compounds across several auto-immune disorder indications.

Ventyx is a classic example of Third Point's ability to be lifecycle investors throughout a company's phases of development – from early stages to IPO and beyond. After returning multiples of our initial investment, we remain confident in the company's future supported by the successful milestones they have reached indicating marketable products based on the strong emerging clinical data.

## **Business Updates**

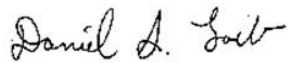
We recently welcomed two new team members to Third Point.

**Beau Teal:** Beau Teal joined Third Point in 2022 with a focus on consumer discretionary. Previously, he was a senior analyst at Melvin Capital investing in consumer and internet. Prior to joining Melvin, he worked at Bank of America Merrill Lynch as an investment banking analyst in the firm's Financial Institutions group. Mr. Teal graduated with distinction

from the University of North Carolina where he earned a B.S. in Business Administration and Economics.

**Pranav Venkatraman:** Pranav Venkatraman joined Third Point in September 2022. Prior to joining Third Point, Mr. Venkatraman worked at Castlelake where he focused on investments in aviation and specialty finance. Prior to Castlelake, he served as an Associate at HIG Capital, focusing on distressed debt & special situation investment opportunities. He began his career at Rothschild & Co as an investment banking analyst. Mr. Venkatraman is a graduate of Emory University, where he earned a B.B.A with a concentration in finance.

Sincerely,

A handwritten signature in dark ink, appearing to read "Daniel S. Loeb". The script is fluid and cursive, with the first name "Daniel" and last name "Loeb" clearly distinguishable.

**Daniel S. Loeb**

**CEO & CIO**

Third Point Investors Limited (the “Company”) is a feeder fund listed on the London Stock Exchange that invests substantially all of its assets in Third Point Offshore Fund, Ltd (“Third Point Offshore”). Third Point Offshore is managed by Third Point LLC (“Third Point” or “Investment Manager”), an SEC-registered investment adviser headquartered in New York.

Unless otherwise stated, information relates to the Third Point Offshore Master Fund L.P. Exposures are categorized in a manner consistent with the Investment Manager’s classifications for portfolio and risk management purposes in its sole discretion.

Performance results are presented net of management fees, brokerage commissions, administrative expenses, and accrued performance allocation, if any, and include the reinvestment of all dividends, interest, and capital gains. While performance allocations are accrued monthly, they are deducted from investor balances only annually or upon withdrawal. From Fund inception through December 31, 2019, the Fund’s historical performance has been calculated using the actual management fees and performance allocations paid by the Fund. The actual management fees and performance allocations paid by the Fund reflect a blended rate of management fees and performance allocations based on the weighted average of amounts invested in different share classes subject to different management fee and/or performance allocation terms. Such management fee rates have ranged over time from 1% to 2% per annum. The amount of performance allocations applicable to any one investor in the Fund will vary materially depending on numerous factors, including without limitation: the specific terms, the date of initial investment, the duration of investment, the date of withdrawal, and market conditions. As such, the net performance shown for the Fund from inception through December 31, 2019 is not an estimate of any specific investor’s actual performance. For the period beginning January 1, 2020, the Fund’s historical performance shows indicative performance for a new issues eligible investor in the highest management fee (2% per annum) and performance allocation (20%) class of the Fund, who has participated in all side pocket private investments (as applicable) from March 1, 2021 onward. The inception date for Third Point Offshore Fund Ltd is December 1, 1996.

While the performance of the Fund has been compared here with the performance of a well-known and widely recognized index, the index has not been selected to represent an appropriate benchmark for the Fund whose holdings, performance and volatility may differ significantly from the securities that comprise the index. Investors cannot invest directly in an index (although one can invest in an index fund designed to closely track such index).

All performance results are estimates and should not be regarded as final until audited financial statements are issued.

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