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January 21, 2014

**Fourth Quarter 2013 Investor Letter**

**Review and Outlook**

At the beginning of 2013, we identified four areas we expected would drive performance in the coming year. We explained in our January 2013 Investor Letter that: 1) reduced macroeconomic volatility would lead to less correlated markets and increased rewards for superior stock picking; 2) the same phenomenon would drive capital flows into equities, increasing equity valuation multiples generally; 3) corporate activity would increase and finally; 4) Abenomics would cause Japanese markets to outperform. Most of our predictions proved to be correct, although we underestimated the magnitude of multiple expansion and extent of the market rally that occurred during the year.

Our overall returns were arrayed across the portfolio. Of the year's ~26% gains, equities contributed ~18%, corporate credit added ~3%, structured credit contributed ~3%, and macro investments added ~2%. We generated meaningful alpha in Technology, Media and Telecom investments, European equities, performing credit, and U.S. residential mortgage-backed securities. While overall performance was solid, there were certain areas where we could have done better. The Japan portfolio disappointed later in the year as Sony underperformed the broader market, and we missed a number of event-driven opportunities in the Health Care sector.

In 2014, we believe still-improving global economic conditions will deliver better growth. In the U.S., it appears now that we will avoid a budget impasse. Closely monitoring communications from the Federal Reserve remains critical, as any signs that rates will rise sooner than currently expected will act as a ceiling on multiples. Unfortunately, well-intentioned government policies and regulation have dampened economic growth and workforce participation and thus, overall employment. We believe that potential tapering will be mitigated by the continuing weakness in job growth.

Although "Street" sentiment has become more negative recently, we expect earnings to rise modestly and the economy overall to surprise to the upside from these increasingly pessimistic projections. Japan will be a high-beta trade. Gains will be driven by BOJ policies and potentially by Japanese citizens investing in the markets in anticipation of inflation. Both scenarios, however, face a road block in the form of the increasing consumption tax. We expect continued growth and stability in China.

While market multiples have re-rated, an environment of accelerating GDP growth combined with low inflation and low short-term rates is more likely to result in continued multiple expansion rather than contraction. We are concentrating on identifying companies that have been under-earning relative to normalized earnings power. Corporate credit opportunities will most likely be slim pickings, with exposure levels close to those in 2013. It should be another interesting year in structured credit, particularly as we look beyond the U.S. in both residential and commercial mortgage bonds. We believe our portfolio is well-positioned with a number of event-driven situations, and we expect corporate activity to create compelling opportunities for our investment style.

Of course, any outlook presented is a base case for our expectations of general market conditions and represents our most likely scenario today. We are constantly on the lookout for threats and are prepared to change course should events in the U.S., Europe or Asia unfold differently than anticipated.

**Quarterly and Yearly Results**

Set forth below are our results through December 31st and for the year 2013:

| | Third Point Offshore Fund Ltd. | S&P 500 |
|---|---|---|
| 2013 Fourth Quarter Performance | 6.1% | 10.5% |
| 2013 Year-to-Date Performance* | 25.2% | 32.4% |
| Annualized Return Since Inception* | 18.0% | 7.3% |

*Through December 31, 2013. ** Return from inception, December 1996 for TP Offshore Fund Ltd. and S&P 500.

**Select Portfolio Positions**

**Equity Position: The Dow Chemical Company**

Third Point's largest current investment is in The Dow Chemical Company ("Dow"). Dow shares have woefully underperformed over the last decade, generating a return of 46% (including dividends) compared to a 199% return for the S&P 500 Chemicals Index and a 101% return for the S&P 500.[1] Indeed, in April 1999, nearly 15 years ago, an investor could have purchased Dow shares for the same price that they trade at today! These results reflect a poor operational track record across multiple business segments, a history of under-delivering relative to management's guidance and expectations, and the ill-timed acquisition of Rohm & Haas. The company's weak performance is even more surprising given that the North American shale gas revolution has been a powerful tailwind for Dow's largest business exposure – petrochemicals.

1. Capital IQ data as of 1/10/14. Includes stock appreciation plus dividends paid.

We believe that Dow would best serve shareholders' interests by engaging outside advisors to conduct a formal assessment of whether the current petrochemical operational strategy maximizes profits and if these businesses align with Dow's goal of transforming into a "specialty" chemicals company. The review should explicitly explore whether separating Dow's petrochemical businesses via a spin-off would drive greater stakeholder value.

Dow's petrochemical operational strategy has been to migrate downstream, supposedly to earn higher margins, to become more "specialty," and to increase the number of customer-facing products. Over the past five years, the shale revolution in North America has led to a boom in natural gas liquids production which has dramatically reduced raw material costs, while China and other emerging market economies have aggressively grown downstream derivatives capacity. This combination has led to significant upstream margin expansion in North America, where Dow is the largest ethylene producer, and a commoditization of numerous downstream derivatives margins. Dow's current petrochemical strategy seems misaligned with the changed landscape.

Perhaps unsurprisingly, our analysis suggests that Dow's downstream migration strategy within petrochemicals has not yielded material benefits so far and instead may be a significant drag on profitability. We have examined Dow's aggregate petrochemical capacities (and associated industry product margins) and compared its petrochemical cost base and profitability with pure-play peers. Our work suggests that upside from both cost-cutting and operating optimization could amount to several billion dollars in annual EBITDA. We suspect that Dow's push downstream has led the company to use its upstream assets to subsidize certain downstream derivatives either by sacrificing operational efficiency or making poor capital allocation decisions, or both. Poor segment disclosure combined with Dow's opaque and inconsistent transfer pricing methodology for internally sourced raw materials makes it difficult for shareholders (and presumably, the Board of Directors) to ascertain which business units are most challenged. What is easily ascertainable is that the magnitude of the aggregate under-earning warrants a comprehensive strategic review, preferably with the assistance of an objective outside advisor answerable to a special committee of the Board.

We believe Dow should apply the intelligent logic of its recently announced chlor-alkali separation to the entirety of its petrochemical businesses by creating a standalone company housing Dow's commodity petrochemical segments ("Dow Petchem Co.").[2] Such a separation would accomplish two important objectives. First, the split would accelerate

2. Dow Petchem Co. would generally consist of the Feedstocks & Energy, Performance Plastics, and Performance Materials segments.

Dow's transition to a true "specialty chemicals" company focused on attractive end-markets such as agriculture, food, pharmaceuticals, and electronics. Second, the standalone Dow Petchem Co. could realign its strategy away from largely focusing on downstream migration/integration and towards overall profit maximization.

The optimization of Dow Petchem Co. combined with the significant step-up in earnings from organic growth initiatives already put in place by management – the PDH plant, the Sadara JV, and the U.S. Gulf Coast greenfield ethylene cracker – could translate into future EBITDA well in excess of $9 billion on a stand-alone basis. This would be before any improvement attributable to what management refers to as the "ethylene upcycle". Both the "self-help" and cyclical upside opportunities create a compelling investment case, which is not reflected in Dow's current share price considering the entire company's 2013 EBITDA base is ~$8 billion.

Despite Dow's best efforts to migrate downstream and become a specialty chemicals company, the market remains unconvinced. By creating Dow Petchem Co., the strategic direction of these businesses would no longer be dictated by the broader Dow strategy of becoming more specialty-focused. Instead, management could transform these businesses into a best-in-class, low-cost commodity petrochemical company.

The remaining Dow Chemical ("Dow Specialty Co.")[3] would be the specialty chemicals leader that Dow has aspired to become over much of the past decade. Here too, we see meaningful upside over the coming years:

- In Dow's Agricultural Sciences segment, significant investments have been made in R&D which have yet to translate to profits, most notably in the development of Dow's ENLIST trait package. We are optimistic that ENLIST will be successfully adopted in the South American soybean market, where it has a natural first-mover advantage given that the 2,4-D herbicide is approved for use in Brazil and Argentina. The South American soybean opportunity alone for ENLIST could increase divisional EBITDA by 30-40% once fully penetrated.
- In the Electronics & Functional Materials segment, we see niches with strong end-market growth and high barriers to entry, leading to above-GDP growth rates and sustainably robust returns on invested capital.
- Finally, the Dow Corning JV represents a valuable call option on solar power adoption as total system costs for solar continue to compress and become

3. Dow Specialty Co. would generally consist of the Agricultural Sciences, Coatings & Infrastructure, and Electronic & Functional Materials segments.

increasingly competitive with other fossil-fuel electricity alternatives in much of the world.

Dow Specialty Co. should command a premium to Dow's current multiple, and potentially a premium to other specialty chemicals companies given its attractive EBITDA growth prospects. The market is skeptical of Dow's divisional margin targets given the lack of clarity around how they were derived and the lack of progress toward achieving them. However, even if management fails to attain their targets, we still see the potential for Dow Specialty Co. EBITDA to ramp up to the \$4-5 billion range over the next 3 to 5 years, compared to a 2013 base of ~\$2.8 billion.

We believe management's main concern about a spin-off of Dow Petchem Co. will likely relate to the integrated nature of Dow's overall portfolio. Importantly, the majority of the integration in Dow's portfolio exists between upstream / downstream petrochemicals and these businesses would remain together in Dow Petchem Co. In addition, the integration between Dow Petchem Co. and Dow Specialty Co. is limited to commoditized raw material transfers. Having some amount of commoditized raw material integration does not create differentiation in specialty products nor does it materially increase margins (unless the raw material inputs are being subsidized by Dow's petrochemical segments). The segments within Dow Specialty Co. which primarily consist of legacy Rohm & Haas businesses and Dow's Agricultural Sciences segment have successfully operated without raw material integration in the past, or have peers that are able to achieve higher margins without any raw material integration.

We appreciate this consideration; it is why we have contemplated a scenario in which both the upstream and downstream petrochemical businesses are spun-off together into Dow Petchem Co. We believe the benefits from a spin-off, including financial uplift from operational improvements at Dow Petchem Co. and the potential valuation uplift from increased business focus and disclosure, far outweigh the supposed integration benefits.

Finally, as Dow management looks to further its journey in unlocking value for shareholders, it now has the balance sheet flexibility to consider a meaningful share buyback that could more than offset the share issuance from the conversion of the Warren Buffett/KIA securities issued in conjunction with the financing of the Rohm & Haas acquisition.[4] Combined with the Dow Petchem Co. spin-off, Dow could pave a path toward increased disclosure, greater management accountability for individual business segment

4. Dow has \$4.0 billion in outstanding 8.5% convertible preferred securities issued to Berkshire Hathaway and the Kuwait Investment Authority. The \$340 million annual dividend payments are not tax-deductible. The securities may be converted to equity at Dow's option beginning in April 2014, if Dow's closing share price exceeds \$53.72 (130% of the "conversion price") for 20 trading days within any period of 30 consecutive trading days.

performances, and enhanced alignment of interests between management and shareholders. With the difficult task of balance sheet de-levering behind it, Dow finally has the opportunity to embark on its next transformational deal during CEO Andrew Liveris' tenure.

**Equity Position: Ally Financial**

Third Point has invested across the capital structure of Ally Financial, the former GMAC, throughout the company's multi-year reorganization. Today's Ally Financial ("Ally") fits the pattern of other profitable investments we have made: a highly successful, nearly-completed restructuring that remains undervalued, with an explosive earnings story led by a talented management team who are economically aligned with shareholders.

We invested initially in 2011 in Ally's unsecured debt and preferred securities because we believed market estimates of potential liabilities related to the company's wholly owned mortgage subsidiary, Rescap, were excessive. When Ally stopped funding its losses through direct loans and sought to distance itself from Rescap's ballooning potential liabilities in 2012, Rescap filed Chapter 11. After nearly one year of creditor negotiations, Ally permanently settled all mortgage related liabilities for approximately $2 billion, a figure that was consistent with our expectations. During this period, Ally initiated a radical operational restructuring that included divesting all of its international operations and their associated $30 billion of assets and jettisoning Rescap, transforming Ally into a pure-play North American auto finance company with leading market share.

Under normal conditions, a financial services company with $185 billion in assets undergoing a substantial restructuring would attract significant interest from investors. However, until November 2013, Ally remained 75% owned by the US government, under the terms of the Federal government bailout of General Motors during the financial crisis. With Ally's debt instruments trading above par following Rescap's bankruptcy filing, distressed players moved on to other opportunities and traditional equity investors dismissed the opportunity given the small float. Over the past six months, we have become one of Ally's largest shareholders, acquiring approximately 9.5% of the company in a series of private transactions.

Ally has announced a strategic plan to achieve increased profitability driven by improved cost of funding and balance sheet optimization, reduction in structural costs associated with divested international assets, and the easing of regulatory constraints still remaining due to the legacy Rescap relationship and government ownership. It has already begun reducing its high-cost funding structure through liability management, and recently received upgrades from S&P, Moody's, and Fitch, putting most of its debt instruments within striking distance of investment grade. The $1.3 billion primary capital raise in Q3 has strengthened Ally's capital metrics and should allow for greater future regulatory flexibility, mainly via increased funding from its rapidly growing online bank which has more than $50 billion in deposits. Last week's successful placement reduced the government's holdings to 37%. Finally, Ally recently received Fed approval for its Financial Holding Company application, a designation that will allow it to keep its competitive advantage of serving as a "one stop shop" for auto dealers providing retail and wholesale financing, insurance, and auction services.

Our confidence in Ally's ability to execute on its ambitious restructuring plan is driven by the leadership of Mike Carpenter, its talented CEO, and the company's deep management bench. In the last 12 months, Mr. Carpenter has guided Ally through one of the largest and fastest restructurings we have witnessed. Divesting $30 billion of assets on four continents and resolving a highly complex bankruptcy of a subsidiary are only the beginning of the story from this team, and we expect them to execute on their multi-year plan to significantly increase Ally's earnings. Nearer-term, we believe Ally will be in a position to exit TARP with full government repayment during 2014, most likely through an IPO. Ally's underlying assets are low risk, with normalized credit losses of ~50bps and peak losses during the crisis of only ~100bps. The assets are short duration, typically 2½ to 3 years, resulting in a balance sheet that can quickly benefit from rising rates. These factors have led both debt and equity investors historically to apply low cost of capital requirements to securities backed by auto loans. We believe Ally is poised to grow its capital base and ultimately achieve a multiple significantly in excess of 1.0x book value, well above the valuation of our purchase levels.

**Equities: TMT Update**

Third Point's gains in 2013 were led by significant equity investments in the technology, media and telecom sectors. These were primarily in companies where we successfully identified mispriced underlying assets with imminent catalysts we believed would prompt an increase in value.

We are tracking a number of key themes in 2014, including the rise of the "app economy", next generation messaging applications, China's next leg of mobile-driven internet growth, and continued heightened M&A activity. The markets have endorsed accretive M&A and TAM ("Total Addressable Market") expansion, as seen by recent transactions between Avago and LSI as well as FireEye's acquisition of Mandiant. The media sector has been disciplined in terms of capital allocation and return, and executives are watching rates and looking to take their turn at accretive acquisitions. Similar dynamics are at play in the semiconductor sector, specifically among analog and mixed-signal semiconductors companies. In the telecom/cable space, we expect further consolidation in the U.S. and European cable sectors, and consolidation in the global wireless industry. The wireless market is poised to morph into a global scale game, with cross-border M&A potential in Europe, Latin America, and emerging markets. Overall, the trading opportunities around M&A should remain robust globally in 2014.

In each of our current core investments – Softbank, Sony, and T-Mobile – we see the potential for increased value in 2014. Key expected catalysts include:

**Softbank** – Softbank has a portfolio of high-profit, cash-generative growth businesses with critical events expected to unfold in 2014. Softbank's Japanese wireless business continues to maintain strong market share in the wake of NTT DoCoMo's launch of the iPhone, and will now enter a phase of ARPU growth as it laps LTE promotions from 2012. Impressive free cash flow generation in the domestic wireless business continues to fund high ROI investments in strategic growth assets like Brightstar and SuperCell. Alibaba continues its march toward an IPO, with U.S. analysts leading in raising valuation estimates, while the Japanese analyst community continues to lag.

More recently, Sprint has surfaced as a source of meaningful upside potential in the context of a rumored merger proposal for T-Mobile. Initial analyst work in the U.S. indicates $20-30 billion NPV of synergies, with Softbank set to capture 60-70% of those, implying ¥1,100 - 1,600 per share of upside to our Softbank valuation should this scenario unfold. Softbank is led by one of the world's premier creators and compounders of value, Mr. Masayoshi Son, its founder and CEO.

**Sony** – While the rejection of Third Point's proposal to partially list the Entertainment business proved costly for shareholders, we are hopeful that the Company's commitment to improve transparency, increase margins, better allocate capital among divisions, and hold division management accountable will lead to our goal: increasing shareholder value. Despite the rise in the Company share price earlier in the year, Sony shares still trade significantly below their sum of the parts valuation.

Sony started 2014 strongly at the Consumer Electronics Show in Las Vegas, winning two best-of-show awards for PlayStation 4 and the Xperia phone. The show's highlight was news that Sony had sold 4.2 million Playstation 4's in 2013 versus 3.0 million Xbox One's. Sony appears set to sustain strong global momentum with the Japanese launch of the Playstation 4 in February. February is also rumored to mark the launch of Sony's Xperia Z2 phone, with the potential for meaningful distribution expansion in North America and elsewhere.

Progress on Sony's growth vectors, while encouraging, needs to be matched by a serious effort to restructure the PC and TV businesses as well as more concerted efforts to realize

Entertainment's value. Japanese investors reacted favorably to management teams who took bold restructuring action in 2013, and the market is looking for Sony to pursue a similar path.

Meanwhile, we are focused on upcoming catalysts including the IPO of Japan Display indicated for 1Q '14, progress at VEVO, and increasing focus on Sony's considerable intellectual property portfolio. Sony, a perennial top 10 U.S. patent approval recipient (#4 in 2013) with over 50,000 patents and several distinct patent assets, including stakes in InterTrust, MobileMedia Ideas, and participation in the Rockstar Consortium, still exhibits a disconnect between the implied value of the Electronics business and the underlying value of its intellectual property.

All eyes are focused on management to reach its margin targets both within the Electronics and Entertainment divisions over the course of the coming year. We have high hopes for CEO Hirai and his lieutenants to continue their path towards greater profitability and to make difficult decisions when necessary to reach those goals

**T-Mobile** – We had the opportunity to establish a position in T-Mobile in November when the Company conducted a secondary offering at $25. The offering represented a favorable relative valuation versus peers, enhanced by recently improved relative operating performance and an attractive EBITDA growth trajectory.

In addition to T-Mobile's fundamental value proposition, the Company is strategically interesting for Sprint and potentially DISH, which has driven shares higher. The analyst community has offered mixed messages on the prospects for a merger with Sprint, indicating an unwillingness on the part of the DoJ and FCC to approve consolidation while acknowledging the significant financial and scale disadvantages Sprint and T-Mobile face and the inevitability of a combination. Perhaps the starkest examples of the reality of the U.S. wireless industry are the incredible gaps analysts expect in subscriber net additions and free cash flow between 2013 and 2015. During the same period, Sprint and T-Mobile are expected to continue to lose share on a combined basis, attracting less than 15% of industry net additions compared to their current joint subscriber market share of just under 30%. Meanwhile, AT&T and Verizon are expected to generate over $83 billion of combined free cash flow between 2013 and 2015, while Sprint and T-Mobile are expected to burn an unhealthy $10 billion of cash together as they cede market share.

Some pundits have expressed concern over a merger with Sprint based on a potential supposed loss of a "maverick" in the marketplace. This view ignores Masayoshi Son's reputation as the ultimate maverick – one who would likely look to convert substantial synergies into market share gains enabled by amplifying the innovative business practices

T-Mobile's dynamic management team has imported to the U.S. market (apparently from Softbank in Japan). Without a combination, Sprint and T-Mobile are expected to play out the sell-side narrative, ceding share while becoming increasingly ripe targets for the massive financial firepower of AT&T and Verizon. While the environment for legitimate business combinations faces potentially unfriendly regulatory dynamics, the combination of Sprint and T-Mobile creates the only real counterbalance to a decade-long market and profit share grab by the industry's two largest players.

**Equity Position: Intrexon Corporation ("Intrexon")**

We initially invested in Intrexon in 2011 in a private round and have continued to accumulate shares since its IPO in August 2013. We believe that Intrexon is an innovation leader in synthetic biology with a unique value proposition and proven leadership team. Most attractive to us is Intrexon's potential to transform *multiple* industries, including the health, food, and energy markets.

Synthetic biology is an emerging discipline that applies engineering design principles to biologic systems. Broadly speaking, synthetic biology is about the design, modification, and regulation of gene programs to produce a desired outcome, such as the production of a novel antibody from a cell culture, the optimization of a specific gene trait in crops, or the amplification of wild type natural gas metabolism into an industrially feasible process. Over the past 15 years, Intrexon has developed deep expertise in synthetic biology as well as the adjacent fields of process optimization and data analysis to create a unique technology platform that enables the iterative, directed improvement of experimental design.

To leverage its technology with collaborators, Intrexon has developed a unique business model that centers on Exclusive Channel Collaborations (ECCs) with partners. In exchange for providing access to their technology, Intrexon receives cost reimbursement (thus mitigating the need to raise additional external funds) and significant downstream economics. Because Intrexon's technology is scalable, its capacity to sign ECCs across multiple industries is limited only by the ambition of its partners. Indeed, to date, Intrexon has already signed over 15 ECCs including, notably, with Johnson & Johnson. Over the course of 2014 and beyond, we anticipate that Intrexon will sign multiple ECCs, creating a broad pipeline of projects and diversifying away from specific product risk.

Intrexon is led by Chairman and CEO Randal J. Kirk, one of the most successful healthcare leaders of all time. Kirk founded and led New River Pharmaceuticals until its acquisition by Shire, and led Clinical Data through the successful development and approval of the anti-depressant Viibryd before selling the company to Forest. While his track record of value creation speaks for itself, we especially like that Kirk has personally invested significantly in Intrexon's success through Third Security, which owns nearly 2/3 of Intrexon's shares outstanding.

While Intrexon's business model may seem foreign to the healthcare industry, it reminds us of an undisputed technology leader: Qualcomm. Qualcomm out-licenses its CDMA technology and in return receives significant economics from its partners upon commercialization; the explosive growth of the global wireless communication market and its dominant position has driven Qualcomm to a $125 billion market cap. While we aren't saying that Intrexon will become a $125 billion company overnight, we will note the following two points: (1) the manipulation of DNA and gene sequences to produce beneficial outcomes is a well-established paradigm; (2) the global health, food, and energy markets dwarf the wireless communication market in size.

Sincerely,

**Third Point LLC**

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