THIRD POINT

Third Point LLC
390 Park Avenue
New York, NY 10022
Tel 212 715 3880

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Second Quarter 2016 Investor Letter

Review and Outlook

Watching Jon Snow's epic "Battle of the Bastards" scene in the penultimate episode of this season's *Game of Thrones* gives investors a sense of how it has felt to manage money during some periods over the past year. Surging enemies forming a seemingly impossible perimeter, a crush of fellow soldiers on the field, arrows coming in overhead, and the need to avoid panic and deftly use sword and shield to fight your way out of a seemingly impossible situation is a good analogy for the emotional experience of managing assets since last summer.

Nearly one year into this market cycle, a few truths of hedge fund investing are evident: 1) portfolio positioning matters as much as stock picking skill; 2) factor risk, not beta, has driven hedge fund underperformance in an up market; 3) crowded trades are a symptom of the prevalence of copycat investment frameworks practiced by hundreds of funds formed over the past decade to mimic the success of many of their investing legend mentors and therefore naturally share the same outlooks and biases; and 4) putting money to work in equities and credit today requires a thoughtful perspective on global events. Macro analysis is no longer just for macro traders.

The Brexit vote was a good example of the importance of being able to make decisions about the real impact of political and economic events in the midst of market turmoil, and many market participants were caught flat-footed. The idea that the outcome was unforeseeable is incorrect – the polls correctly forecast a coin flip – but elites dismissed the possibility. There is a lot to learn from this group-think pitfall, which we nearly fell into ourselves. Over the weekend following the vote, we investigated the actual impact of Brexit and, after concluding the average predicted scenario was too severe, we quickly repositioned our equities portfolio by covering shorts, adding to several long positions, and

initiating a new position in a European event-driven situation. This helped generate positive returns for the month, for Q2, and so far in July.

As the Brexit episode showed, investing in this market must be viewed through a different lens. This year, we have applied our views about global risks to portfolio management and maintained a highly flexible, opportunistic approach. Our net equity exposures have ranged from ~40% to ~55% in 2016, allowing us to be proactive in periods of market sell-offs while still taking enough risk to generate returns. We came into the year with a short credit portfolio that we reversed sharply in February, getting long over $1B in energy credit, a trade we discuss further below. We have reduced our structured credit book of housing-related bonds from its highs and focused increasingly on new areas of opportunity in consumer lending. The year's positive performance reflects contributions from nearly all of the strategies we employ; the top five winners include a constructive long equity position, a sovereign debt investment, high-yield debt investments in energy companies, an event-driven long position, and a short equity position in the pharmaceutical industry.

Our gains have also been the result of mitigating losses in individual investments (other than in Allergan, the year's largest detractor). We believe that improved process initiatives we have practiced since 2009 – which have helped us annualize at nearly 16% net since then – have helped to avoid dramatic downside in more challenging markets over the past 18 months. A few key shifts have included: 1) moving away from a team populated by generalist event-driven investors to a firm of sector specialists focusing on three distinct areas of equity investing: event-driven situations, constructive/activist situations, and value compounders. In a market with low growth and fewer events, having more depth of knowledge in each sector and more types of equity investments available to us has resulted in better stock picking; 2) an increased focus on controlling net, gross, and factor exposures and shying away from most crowded longs and shorts has allowed us to be proactive in market sell-offs.

Looking ahead, we remain constructive on US markets and are primarily invested here. While observers claim the S&P is expensive, its dividend yield currently is greater than the

30 year bond yield, a relatively rare occurrence not seen since 2009. The dollar's strength earlier this year had weakened overall S&P earnings and when combined with its softening, the Fed's signals that another rate hike this year is highly unlikely, and tailwinds from low energy prices, we expect to see earnings improve in the second half. Share buybacks and M&A remain robust. Viewed from this perspective, alongside the observation that very few other asset classes or regions offer more attractive returns, we are content to have our capital in a well-diversified portfolio of US-centric credit and equities.

Quarterly Results

Set forth below are our results through June 30, 2016:

	Third Point Offshore Fund Ltd.	S&P 500
2016 Second Quarter Performance*	4.6%	2.5%
2016 Year-to-Date Performance*	2.2%	3.8%
Annualized Return Since Inception**	15.9%	7.3%

*Through June 30, 2016. ** Return from inception, December 1996 for TP Offshore Fund Ltd. and S&P 500.

Portfolio Positioning

Equities: Baxter

A frequent question we are asked is whether we are too exposed to the health care sector. First, we think it matters *where* we are exposed; we see a significant difference between biotech and pharma companies, service companies like hospitals and HMO's, and medical instrument and product companies like Baxter. As health care names in general have swung from darlings to pariahs over the past 12 months, we have consistently reevaluated both our exposure levels and specific investments. While there is temptation to dig in following the types of losses we have seen in the sector, we do not share some investors' belief that every name that has gone down meaningfully will eventually revert to highs. Investors should be particularly skeptical of overleveraged companies with aggressive pricing practices in the current environment.

During the second quarter, we reduced our more concentrated long investments in health care, selling out of our stake in Amgen because we saw better opportunities elsewhere. We continue to hold our Allergan stake.

Our largest investment in the portfolio is Baxter, a global manufacturer and supplier of health care products. Since its inception last June, the position has generated a nearly 20% IRR. Despite this meaningful move in performance, its current size is consistent with our conviction about the company and its leadership and the potential we see for meaningful upside from these levels.

Our active involvement in Baxter began last summer immediately following the July 1st divestiture of its biopharmaceuticals business, Baxalta. We believed Baxter had the opportunity to materially improve margins and increase shareholder value. Shortly after the Baxalta split and after we built our stake, Baxter's CEO Bob Parkinson stated his intention to retire and, by the fall of 2015, Baxter's Board of Directors had agreed to add two new members – Third Point Partner Munib Islam and Boston Scientific CEO Michael Mahoney. Munib also joined the search committee for a new CEO and in November 2015 the Board selected seasoned medical device executive and former Covidien CEO Joe Almeida to be Baxter's next CEO effective on January 1, 2016.

Mr. Almeida immediately outlined a three-part strategy to transform Baxter: 1) portfolio optimization; 2) enhanced operational excellence; and 3) disciplined capital allocation. These initiatives are designed to improve total shareholder return and free cash flow generation over the long-term. Mr. Almeida also promised to evaluate Baxter's businesses and research programs and determine which elements of the company's extensive portfolio should remain and which should be discarded.

While still early, we – and seemingly other shareholders – are encouraged by the results of Mr. Almeida's execution of this strategic plan. In particular, we think three specific examples demonstrate the upside still to be realized as the new CEO continues to pursue his plan:

Vivia Shutdown. In early June 2016, Baxter announced the termination of the Vivia home hemodialysis platform developed in collaboration with DEKA Research and Development Corporation. This program had been in development since 2007. Mr. Almeida explained his decision making at a Goldman Sachs Health Care conference last month, saying "as a matter of fact, the NPV of the discounted cash flows for the program for the next ten years was negative. So this allows us to take the cash and redeploy". We expect Mr. Almeida to continue to make sensible decisions like these as he proceeds with his portfolio review.

Updated Long-Term Plans. At Baxter's Analyst Day on May 9th, Mr. Almeida provided updated 2020 guidance including 1) 17-18% operating margins vs 14% previously, 2) 24-25% EBITDA margins vs 20% previously, 3) roughly $2.5B in operating cash flow vs more than $2.0B previously, and 4) free cash flow of roughly $1.75B vs $1.1B previously. The improvement in free cash flow is more than triple the 2016 guidance of $500M+ and implies a growth CAGR of over 35%. In addition, Mr. Almeida introduced a 2020 EPS goal of $2.75-$3.00 per share, implying a 2015-2020 EPS CAGR of 15-17%. The revised operating and EBITDA margin targets are more in line with industry averages and, if met, would drive meaningful underlying earnings growth before consideration of additional capital allocation.

Baxalta Retained Stake. As part of the spinoff of Baxalta, Baxter retained about a 20% stake in the company. At the time of the spin, Baxter's stake was worth just over $4.1B. On January 11, 2016, Baxalta agreed to be acquired by Shire PLC in a cash and stock transaction, giving Baxter shareholders an unexpected windfall. Ahead of the Shire transaction's close on June 3rd, Baxter successfully completed the monetization of the Baxalta stake by: 1) executing on two separate debt exchanges, reducing overall gross debt by $3.7B; 2) exchanging 13.4M shares of Baxalta for 11.5M shares of Baxter, reducing fully diluted shares outstanding by 2.1%; 3) contributing $700M of Baxalta stock to the Baxter US pension, per guidance. These steps allowed Baxter to recognize nearly $5.0B in value from its Baxalta stake, or over 20%.

While most of the attention thus far has been on the strategic focus and long-term management targets, Baxter's balance sheet opportunity deserves specific mention. At the Analyst Day, Baxter's management clearly stated that 2020 EPS guidance excluded any benefit from leveraging the balance sheet. However, given long-term guidance, we can broadly estimate the amount of capital available to management:

- Following the successful management and divestiture of the Baxalta retained stake, Baxter's net leverage declined to 0.6x on net debt of $1.2B, per the disclosure at the May 9th Analyst Day. Guidance implies that Baxter will generate ~$4.5-5.0B in free cash flow between 2017-2020 (vs $1.2B of net debt currently) and ~$2.8-2.9B in EBITDA by 2020.
- If Baxter sought to maintain a net leverage ratio of ~2.0x, the company could have nearly $9.0B of capital to deploy for business development and/or returning cash to shareholders; note that the leverage ratio excludes the benefit from any acquired EBITDA. In the scenario where Baxter simply returns all cash to shareholders through share repurchases and assuming Baxter achieves the midpoint of its long-term operational guidance with no change to multiples, we estimate over $0.75 per share upside to Baxter's 2020 EPS guidance. This would result in a 2015-2020 EPS CAGR of over 20%.

We continue to see meaningful upside in Baxter and multiple ways to win as Mr. Almeida executes on his strategic program.

Credit Investments: Energy

Investments in energy credit drove positive returns for Third Point during the first half of the year. We began 2016 short corporate credit with modest exposure consistent with our 2015 portfolio and an overall bearish market. There were a few signs that the market's degree of pessimism was misplaced, as Goldman Sachs highlighted in a January note to clients:

"HY E&Ps are pricing in more losses than anything ever experienced, even in the CCC space…HY E&P spreads are implying a cumulative loss rate of 86%, assuming a buy and hold

strategy on the current universe. This means an investor would still break even if 86% of the current HY E&P portfolio were wiped out. For context, data from Moody's show that since 1985, the worst cohort of Caa-rated firms experienced a five-year cumulative default rate of 71%."

Early in the year this (prescient) observation provided little comfort to investors who, having suffered through the 4th worst year in the history of the high-yield market in 2015 (only exceeded by the credit crisis years of 1990, 2000, and 2008), watched as oil plunged through $30/bbl and natural gas traded with a one-handle.

We shifted our portfolio in late Q1, driven in part by our analysis of the energy markets and our approach to cross-capital structure investing. In late January, Moody's revised its 2016-2018 Brent forecasts to $33 / $38 / $43, triggering multi-notch downgrades for many E&Ps. Forced selling by index funds following such downgrades caused many bonds to gap down in price as a large portion of the space transitioned from trading on yield to expected recovery in a bankruptcy scenario. In mid-February, days after rumors of Chesapeake's imminent Chapter 11 filing, another rumor surfaced that OPEC was willing to cut production. This led oil prices to bottom, finally.

Around this time, we saw the potential for a modest commodity price recovery and also believed the market was underappreciating the potential of a broad-based "equitization" of the energy sector (asset sales, equity raises, dividend cuts). As creation value through various credits reached levels that were too cheap to ignore and our view on commodities strengthened, we covered shorts and added quickly to opportunities on the long side. While our team also evaluated expressing our view on energy via equities, and made some modest investments there, we chose to invest the bulk of our energy exposure in credit because we believed that the "fulcrum" securities available offered the best relative risk/reward based on the range of scenarios we analyzed.

We recently have monetized several investments that imply a more optimistic commodity price outlook than we are willing to underwrite. We are currently focused on debt of

companies with high-quality assets and deleveraging catalysts where we can make good returns while limiting downside risk should commodity prices stagnate. As credit markets continue to reflect overall skittishness and volatility, we are optimistic that our flexible approach to investing in the space will continue to provide more opportunities for meaningful returns like the ones we generated during the first half of this year.

Private Investments: Didi

Over the last few years, ride-sharing has emerged as a global disruptive technological force on par with retail ecommerce in economic scope and scale. We believe that as ecommerce has done over the past decade, ride-sharing and related autonomous driving technologies will create new industries, disrupt others, and permanently change the global economic landscape over the next decade. In light of this thesis, we completed a private investment in China's leading ride-sharing platform, Didi, in Q2. Despite the rapid growth of Didi and its rivals over the last three years, ride-sharing penetration in China is still quite low: less than 5% of China's urban population currently uses ride-sharing services and ride-sharing represents less than ~1% of all urban transportation in China.

While ride-sharing is rapidly gaining traction in numerous markets around the world, we view China as a particularly attractive market for ride-sharing expansion thanks to several differentiating factors. China has among the highest population density levels of any large country and is home to nine of the world's 30 largest cities. Ride-sharing platforms tend to work best in densely populated cities because they provide a liquid supply of available drivers, consistent rider demand to attract drivers, and correspondingly short waiting times. China also has a relatively low level of car ownership, with only 130 vehicles per thousand people (vs 800 in the US and 500-700 in Western Europe). Given chronic traffic in China's cities and the lack of available real estate for parking, a mainstream culture of private car ownership in China has not yet developed and most urban residents still rely heavily on public transportation.

As a result of these tailwinds, China's ride-sharing sector is rapidly capturing market share from both public transport and private car ownership. We forecast that the Chinese ride-

sharing market will expand from its 2015 volume level of less than two billion annual trips to ~25 billion annual trips by 2019, representing a market size of ~$100B, or ~9% of the Chinese urban transportation market. Given the "winner-take-most" characteristics of ride-sharing (which result from supply-side economies of scale and network effects) and Didi's already-dominant position in the Chinese market (~80% market share today), we believe Didi can capture the vast majority of this substantial market opportunity. As a result, we expect Didi to grow into one of China's largest internet companies, resulting in significant equity appreciation over the next five years.

Business Updates

New Research Team Members

We are pleased to welcome Greg Hart, C.C. Melvin Ike, and Zohair Rashid to the investment team at Third Point.

Greg is focused on the technology, media, and telecom (TMT) sectors. Prior to Third Point, he worked as an investment analyst at Hoplite for two years. Before joining Hoplite, Greg worked at Blackstone as an analyst in the Private Equity group, and at J.P. Morgan as an investment banking analyst. He graduated from Dartmouth College as Valedictorian with a B.A. in Economics in 2010.

Mel joined Third Point full-time in June, after completing an MBA Summer Internship here in 2015. Previously, he was with TPG Capital where he focused on private equity investments. Prior to TPG Capital, Mel was an investment banking analyst in the Restructuring and Reorganization Advisory Group at Lazard Frères. He earned a JD, *cum laude*, from Harvard Law School where he earned numerous Dean's Scholar Prizes, and an MBA with High Distinction from Harvard Business School, where he graduated as a George F. Baker Scholar, was the winner of the John L. Loeb Prize, and graduated with the highest academic standing in the Finance Department. Mel received his B.S. in Biomedical Engineering with a Cellular and Biomolecular concentration from the University of Texas in 2007.

Zohair will focus on health care investments at Third Point. From 2012-2016, Zohair was a Senior Analyst at March Altus Capital Management, a health care-focused investment management firm. Prior to March Altus, he was an Associate with Kohlberg, Kravis, Roberts, & Co.'s North American Private Equity group. Before joining KKR, he was an Analyst with Lehman Brothers/Barclays Capital. Zohair earned a Bachelor of Business Administration from the University of Texas at Austin in 2008.

Investor Quarterly Call

The Q2 Investor Call was held on July 26th. A replay is available until August 9th and can be accessed by contacting Investor Relations.

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Third Point LLC

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