Orbis Global Equity

As contrarian investors, we seek to look at the world from different vantage points in the hope of finding the value that others miss. This requires not only stepping back to see the broader picture, but also conducting extensive research to build the conviction necessary to take a differentiated view. Our investment in XPO Logistics, one of the portfolio's top holdings, stands out as an illustration of this approach. From afar, the market finds much to dislike about XPO. Its shares have lagged the FTSE World Index by 40% over the past year and 14% of its shares are sold short. Taking a closer look, we see tremendous long-term value, and a very different picture of XPO than the market does.

While not a household name, XPO is one of the largest transportation and logistics providers in the world, handling about 150,000 shipments per day in more than 30 countries. The company was built by Brad Jacobs, a highly successful serial entrepreneur who serves as XPO's chairman and chief executive. Jacobs initially funded XPO with a sizeable US$70 million investment of his own capital in 2011 and has not sold a single share. Today he owns approximately 16% of the company, which has a market capitalisation of US$2.9 billion.

XPO's detractors argue that the company's "roll-up" strategy—growth through acquisitions in the fragmented transportation and logistics industry—has a low probability of long-term success. This surface view would appear to be supported by both academic research and practical experience. Critics contend that roll-ups are often only one bad deal away from disaster, and XPO's surprise acquisition of Con-way, a much-maligned trucking company, seemed to fit that familiar pattern. The acquisition not only dramatically increased XPO's leverage, but also suggested a drift from its stated focus on high-return, asset-light businesses toward a lower-return, asset-intensive model. The market responded swiftly and severely by derating XPO shares from an enterprise value (EV) to earnings before interest, tax, depreciation, and amortisation (EBITDA) multiple of about 12 to less than 7, the latter being more comparable to that of a traditional trucking company.

We would concede that none of this looks very encouraging on the surface, but we disagree with the knee-jerk mantra that "roll-ups never work." In fact, Jacobs himself previously founded two successful roll-ups that substantially outperformed the stockmarket during his tenure. (United Waste outperformed the S&P 500 by 4.5 times during Jacobs' tenure from 11 Dec 1992 to 26 Aug 1997, and United Rentals outperformed the S&P 500 by 1.5 times during his tenure there from 18 Dec 1997 to 31 Aug 2007.) We believe Jacobs' impressive record across multiple industries indicates something more than just luck. Further, in many ways, XPO is the culmination of the lessons he's learned over three decades of buying and integrating businesses. We view this experience, coupled with demonstrated skill, as reason to believe XPO has much greater than average odds of long-term success.

Importantly, our confidence rests not just on the results that Jacobs has delivered, but also on our assessment of his decision-making process. Over the nearly four years since we first began following XPO, we have had the opportunity to meet frequently with Jacobs and his senior management team, during which time we've gained conviction in him and his team's insight, humility, judgement, and adaptability. At the same time, we've gained confidence in his ability to attract and retain top-notch executives throughout the senior ranks of the organisation and its operating businesses. Our view has also been independently corroborated through extensive reference checks and in-depth discussions with XPO's customers and competitors.

If anything, we believe the Con-way acquisition showcases the savvy, contrarian approach to decision-making that has been a hallmark of great capital allocators. While the market views this as a major strategic shift indicative of a flawed business model, we view the acquisition as a shrewd financial and strategic move that will create significant value for shareholders and position the company favourably for long-term trends within the industry. Jacobs believes this is one of the best deals he has done in his career. We agree.

Financially, XPO paid $2.4 billion for Con-way, a business that generated $496 million of EBITDA over the trailing twelve months. We are confident in XPO's ability to meaningfully improve the profitability of Con-way's less-than-truckload business, which has lagged industry peers, and we expect that the initially targeted synergies of roughly $200 million will ultimately prove conservative as the division's new president, Tony Brooks, cuts costs, culls unprofitable business, and energises a more profit-focused culture. Assuming only $200 million of synergies, XPO will have acquired this business for about 3.3 times EBITDA—roughly 50% below historical multiples for the industry.

Strategically, we believe the addition of transportation assets makes the company's other businesses more valuable, not less, as the market's response implies. Owning its own trucks (rather than just being a broker) makes XPO a more reliable partner to large customers, particularly when capacity is tight, while cross-selling opportunities and the ability to offer a broad suite of services to large customers are likely to help drive share gains across all businesses. Critically, this is what XPO clients want.

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Orbis Global Equity *(continued)*

In the short term, however, investors have been more focused on XPO's debt load, which stands at $5.6 billion or double its market capitalisation. With fears of weakness in China, a potential US recession, and now the unknowable consequences of Brexit, the market views XPO's significant leverage, European exposure, and recent move into more cyclical asset-based trucking with worry. While we are mindful of the volatility and potential risks that such leverage creates, we are comforted by insights gained from our granular, business-by-business analysis of the company.

In our view, XPO's cash flow is best understood as emanating from three distinct pillars. The foundation is contract logistics, a highly stable business that enjoys predictable cash flows due to long-term contracts (5-7 years), high renewal rates (95%+), significant customer switching costs, and limited ongoing capital expenditure requirements. By our estimate, the EBITDA generated by this foundation alone covers the company's interest payments, and is likely to remain resilient in the face of macroeconomic disruptions like Brexit. On top of this, the second pillar comes from XPO's significant asset-light transportation businesses, which consists of truck brokerage, freight forwarding, and intermodal transport. The brokerage business also enjoys countercyclical characteristics, including rising margins during recessionary periods. The final pillar is the asset-based transportation (trucking) business; even if cash flow from this business went to zero, we believe XPO could still comfortably cover its interest expenses.

We also think the equity market poorly understands the inherent cyclicality of XPO's cash flows and gets overly obsessed with short-term transportation news flow. We've found it interesting to see XPO bonds trade firmly on news flow perceived to be negative by equity markets. Indeed, the company's liabilities are spread out manageably over time (73% of debt matures after 2021) and are without any covenants that give us cause for concern. To be fair, XPO has yet to generate free cash flow as it has gone through a meaningful consolidation phase with sizeable investments in technology (over $400 million per year), and real cash outlays relating to things like severance and the cost of terminating uneconomic contracts. Yet all of this is consistent with what we forecast, and, importantly, we expect a positive inflection in free cash flow as this consolidation and investment phase normalises, synergies are realised, and the business continues to grow, all while interest costs decline and capex remains essentially flat.

We believe the realisation of significant cash flow will be an important milestone for XPO, and that this will help reveal the company's intrinsic value to be substantially higher than the current share price. Importantly, management incentives are aligned with shareholders' and tied to driving cash flow and total shareholder return. For instance, a meaningful portion of the management team's long-term compensation is tied to achieving adjusted earnings of $2.75 per share in 2017 and a share price threshold of $60 by April 2018, or, alternatively, achieving $4.30 of adjusted earnings by 2019 and a share price threshold of $86 per share by September 2020. These performance targets, while ambitious, offer some perspective on both the team's internal confidence and the long-term return potential of the stock. As XPO demonstrates its earnings power over time, we believe the value of the company will be multiples above the current market price of $26 per share.

Of course, we cannot be certain if others will come to share our view, but we do know that XPO shares are concentrated in a very limited number of hands. Senior management owns about 18% of diluted shares outstanding. Orbis owns approximately 15% on your behalf, and a collection of five other long-term investors own about 30%. Altogether, we think about two-thirds of the company is owned by investors who believe intrinsic value is substantially higher than the current share price. With passive funds likely holding another 15% of shares, we estimate approximately 80% of XPO shares are in the hands of long-term investors. With 14% of shares being sold short by hedge funds, liquidity could evaporate quickly and push the shares sharply higher if the intrinsic earnings power of XPO that we see becomes clear.

In summary, XPO is a company whose value is difficult to see without careful analysis, a longer-term perspective, and a willingness to defy conventional wisdom. By examining the company through our fundamental, long-term, and contrarian lens, we believe we see value that others have missed.

Commentary contributed by Matt Adams and Adam Karr, Orbis Investment Management (U.S.), LLC, San Francisco

This report does not constitute a recommendation to buy, sell or hold any interests, shares or other securities in the companies mentioned in it ("relevant securities") nor does it constitute financial advice.

Fact Sheet at 30 June 2016

Orbis Global Equity Fund

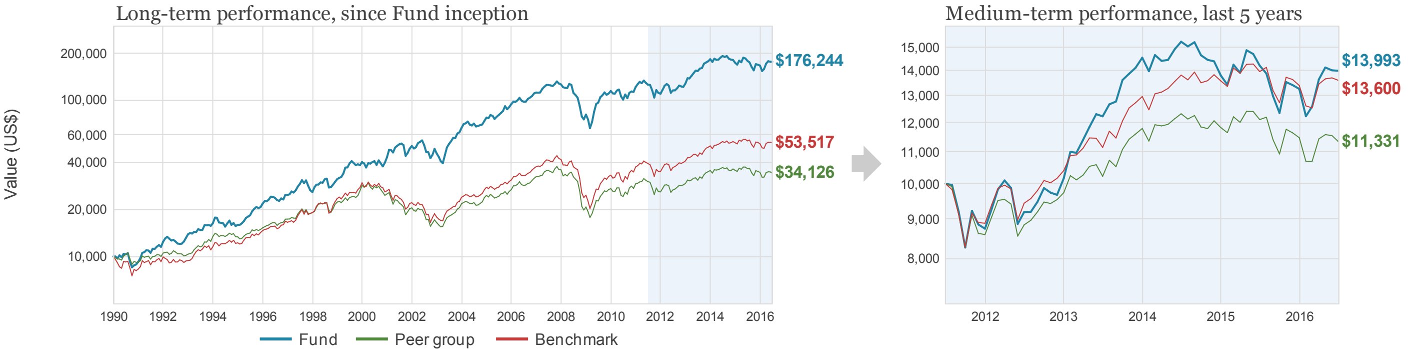
The Fund is designed to remain fully invested in global equities. It aims to earn higher returns than world stockmarkets, without greater risk of loss. The benchmark is the FTSE World Index, including income, gross of withholding taxes (“FTSE World Index”). The Fund’s currency exposure is managed relative to that of the FTSE World Index.

Price	US$176.13
Pricing currency	US dollars
Domicile	Bermuda
Type	Open-ended mutual fund
Fund size	US$6.8 billion
Fund inception	1 January 1990
Strategy size	US$17.9 billion
Strategy inception	1 January 1990

Benchmark	FTSE World Index
Peer group	Average Global Equity Fund Index
Minimum investment	US$50,000 *(Existing Orbis investors)*
Dealing	Weekly *(Thursdays)*
Entry/exit fees	None
ISIN	BMG6766G1087

See Notices for important information about this Fact Sheet

Growth of US$10,000 investment, dividends reinvested



Returns (%)

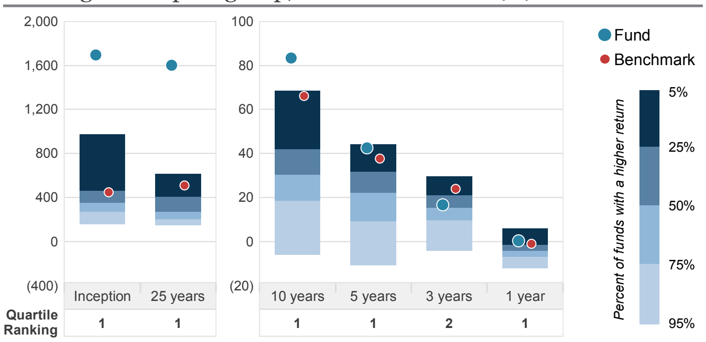
	Fund	Peer group	Benchmark
Annualised		*Net*	*Gross*
Since Fund inception	11.4	4.7	6.5
25 years	11.9	5.2	7.5
10 years	6.1	1.8	5.0
5 years	6.9	2.5	6.3
3 years	4.6	3.5	6.9
1 year	(1.5)	(6.3)	(2.6)
Not annualised			
Calendar year to date	5.5	(1.2)	1.5
3 months	2.6	(0.8)	1.1
1 month	(0.2)		(0.7)

	Year	%
Best performing calendar year since inception	2003	45.7
Worst performing calendar year since inception	2008	(35.9)

Risk Measures, since Fund inception

	Fund	Peer group	Benchmark
Largest drawdown (%)	50	53	54
Months to recovery	42	>104[1]	66
% recovered	100	82	100
Annualised monthly volatility (%)	16.5	14.1	15.3
Beta vs benchmark	0.9	0.9	1.0
Tracking error vs benchmark (%)	9.2	4.6	0.0

Ranking within peer group, cumulative return (%)



Geographical & Currency Allocation (%)

Region	Equity	Currency	Benchmark
North America	47	52	59
Asia ex-Japan	22	7	5
Continental Europe	10	21	15
United Kingdom	7	7	7
Japan	6	9	9
Other	4	4	5
Net Current Assets	*3*	*0*	*0*
Total	**100**	**100**	**100**

Top 10 Holdings (%)

	FTSE Sector	%
NetEase	Technology	6.8
Charter Communications	Consumer Services	4.8
QUALCOMM	Technology	4.8
Apache	Oil & Gas	3.9
Sberbank	Financials	3.5
Barrick Gold	Basic Materials	3.0
Motorola Solutions	Technology	2.9
XPO Logistics	Industrials	2.6
PayPal Holdings	Industrials	2.4
Rolls-Royce Holdings	Industrials	2.3
Total		**37.0**

Portfolio Concentration & Characteristics

% of NAV in top 25 holdings	60
Total number of holdings	122
12 month portfolio turnover (%)	40
12 month name turnover (%)	24
Active share (%)	90

Fees & Expenses (%), for last 12 months

Management fee[2]	1.83
For 3 year performance in line with benchmark	*1.50*
For 3 year outperformance/(underperformance) vs benchmark	*0.33*
Fund expenses	0.05
Total Expense Ratio (TER)	**1.88**

Past performance is not a reliable indicator of future results. Orbis Fund share prices fluctuate and are not guaranteed. Returns may decrease or increase as a result of currency fluctuations. When making an investment in the Funds, an investor’s capital is at risk.

[1] Number of months since the start of the drawdown. This drawdown is not yet recovered.

[2] 1.5% per annum ± up to 1%, based on 3 year rolling outperformance/(underperformance) vs benchmark.

Orbis Investment Management Limited (licensed to conduct investment business by the Bermuda Monetary Authority) **www.orbis.com**

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