Quarterly investor letter March 2015

Castlebay Investment Partners

'In the short term the market is like a voting machine tallying up which firms are popular and unpopular. In the long run, the market is like a weighing machine—assessing the substance of a company.' **Benjamin Graham**

Dear fellow shareholders,

As long term investors, the partners at Castlebay are wary of measuring investment performance over short periods of time, such as a calendar quarter or even a year. Our approach to this quarterly letter is to set out for you our investment philosophy and to update you along the way, in what we hope will be a long and prosperous investment journey with us. As stock-pickers we shall highlight one or two stock examples in each letter. Through our commentary we aim to explain clearly how we 'assess the substance of the companies' in which we invest, whilst ignoring the market herd who 'vote' with increasing frequency and cost, due to their myopia. The value of investments can fall as well as rise and you might not get back what you have invested. Our guiding principles are set out below and we hope you enjoy the read!

Our guiding principles:

- Transparency & alignment of best interests with our fellow shareholders
- Adherence to our investment philosophy and process—high quality & supportive valuations
- Independence of thought in order to avoid the market herd
- A focus on costs: management fees capped, low turnover of companies in the fund

The Portfolio in the first quarter 2015

The launch of the fund at the end of January coincided with a strong recovery in Petrofac which had sold off heavily in the final quarter of 2014 as the price of oil plummeted & investors became irrational sellers of all oil related companies. Tesco also rallied as the market reacted well to the new CEO, Dave Lewis, and his plans to revive Tesco's fortunes. Michael Page was a strong contributor and continues to produce strong earnings with attractive margins. Energy and Natural Resources companies were weaker in the first quarter with Rio Tinto, BHP Billiton and BG negative contributors in the fund.

In February and March we introduced new positions in Aveva, Rotork & our first international business, Kone Corporation. We also carried out our first sale since we started investing at Castlebay in July 2013. We sold Mitie Group.

We think of our fund as if it was one company. A high quality company in its own right. As the 'Key Metrics Table' below illustrates, Castlebay UK Plc's average returns and profit margins are much higher compared to those of the market. Castlebay UK also has lower debt and stronger cash generation than the market. When share prices decline and investor confidence is low we hope you take confidence from the quality of your fund and its ability to generate strong cash flows for the long term.

Key Metrics Table	Castlebay UK	FTSE ex Financials
Return on equity	23%	16%
Operating profit margin	23%	16%
Net debt to equity	24%	40%
Cash conversion	94%	83%
Interest coverage	18x	9x
Dividend Yield	2.5%	3.4%

We cannot predict how share prices will perform in the short term, however, what we can say with some degree of certainty is that the collection of companies in the fund are of higher quality than the market as a whole. Furthermore, our valuation framework is there to ensure that we don't pay too much for them.

Investment journeys are rarely, if ever predictable. Our commitment to our guiding principles and as fellow shareholders means we will always manage your capital as we would our own.

Thank you for your continued support of the VT Castlebay UK Equity fund.

Company	Sector	Position
Petrofac	Energy	6.7%
Shire	Healthcare	5.8%
Admiral Group	Financials	5.3%
BG Group	Energy	4.9%
Rolls Royce	Industrials	4.8%
Tesco	Consumer	4.8%
Wood Group	Energy	4.7%
Capita	Support Services	4.3%
Rio Tinto	Basic Materials	4.1%
Michael Page	Industrials	4.0%
Rotork	Industrials	3.9%
Aveva Group	Technology	3.9%
Victrex	Basic Materials	3.8%
Serco Group	Support Services	3.2%
BHP Billiton	Basic Materials	2.9%
Croda	Basic Materials	2.6%
Kone Corp	Industrials	2.5%
Reckitt Benckiser	Consumer	2.1%
Imperial Tobacco	Consumer	1.9%
Astrazeneca	Healthcare	1.7%
BAE Systems	Industrials	1.6%
BAT	Consumer	1.0%
Cash		19.65%
Total		100.00%

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David F Pollard

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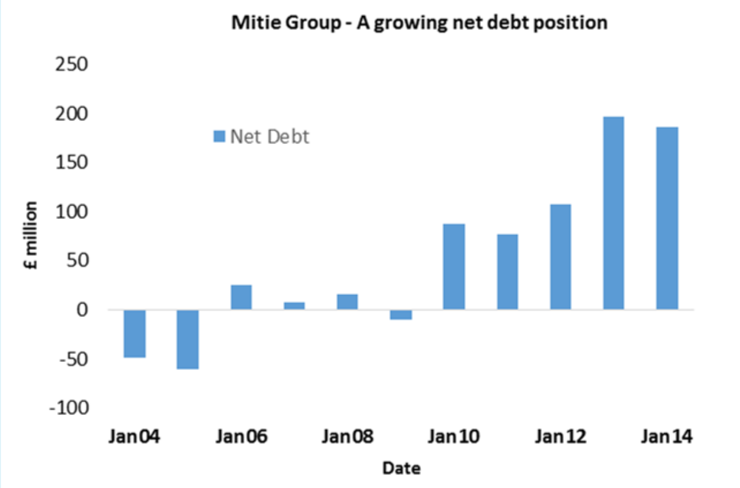
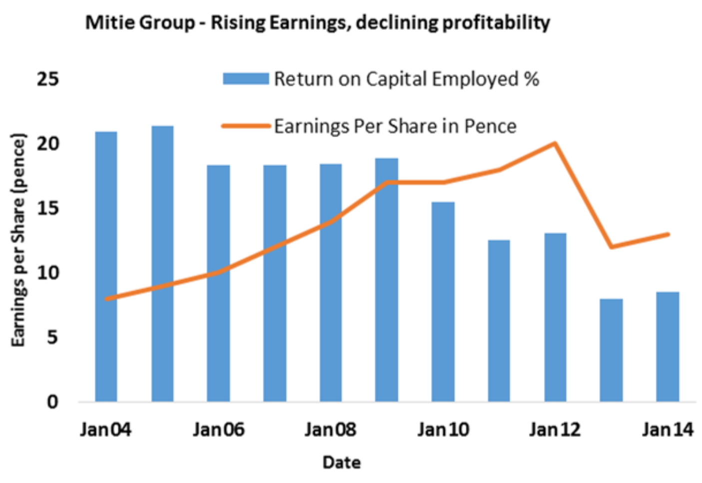
MITIE GROUP

We believe that investment requires balance. It is the balance between Quality and Valuation. Managers can perform poorly even when invested in high quality companies, if they have paid too high a price for the privilege. We recently sold out of our position in **Mitie Group,** a facilities management outsourcing company. Whilst it continues to trade at a material discount to its historic valuation rating - what we would term a 'Valuation Margin of Safety', we became increasingly concerned about a number of factors. In short, we felt the quality of the business and the investment were deteriorating.

We believe that a crucial test of management is its ability to generate consistent returns (return on capital employed and return on equity) above the cost of this capital, over several years. The creation of value should not be defined by growth in earnings, a figure which can easily be manipulated. Following a series of acquisitions over recent years, funded by both an increase in debt and shares in issuance, Mitie Group has seen its return on capital employed fall from above 20% to 8% whilst its earnings per share rose from 8p to 13p. It appears increasingly at risk of destroying value as it seeks to grow its earnings per share. The balance between Mitie's deteriorating quality versus its cheap valuation tipped, leading to the sale of the stock.

We exited our position fully just before Mitie Group announced a profit warning. In truth, we were fortunate with our timing. We are reminded of Napolean's question— "I know he's a good general, but is he lucky?" In investment, especially over the longer term, such moments of good fortune as well as bad timing tend to even out themselves.





KONE CORPORATION

Kone Corporation is a new investment in the fund and our first International company. Our investment objective allows us to invest up to 20% in overseas companies that pass our Quantitative and Qualitative investment process . This is a Finnish company, which makes, installs and maintains escalators, lifts and automatic doors. It may not sound the most exciting of companies, but its returns and the cash it generates from its operations most certainly are! As noted above, Mitie is struggling to make a return on capital employed above 10%. Kone conversely makes a 41% return on equity, with no debt, and converts more than 100% of its profits into cash. The management have long demonstrated their commitment to producing returns for their shareholders which still includes the founding family.

Key investment themes:

- Kone is well placed to benefit from population growth and increasing urbanisation. The company have confirmed that the equivalent of the world's 7.2bn population travel on Kone's products every 3 days, cementing its position as a leader in the market.
- There isn't a valuation margin of safety (MoS), however its dominance in the sector generates an operational Margin of Safety that can be protected for many years to come.
- An attractive owner earnings yield of 4.6% supports the valuation.
- Strong cash flows and the ability to convert profit to cash, support double digit growth in dividends and reinvestment into future growth.

Key Metrics Table	Kone Corp	Mitie Group
Return on equity	41%	15%
Operating profit margin	14%	6%
Net debt to equity	-12%	46%
Cash conversion	140%	83%
Interest coverage	140x	9x
Dividend Yield	3%	4%

Next time you're at an airport , railway station or office block look out for 'KONE' at the base of the escalator you're using. As Mitie exits the fund and Kone is introduced , the overall Key Metrics table of our fund improves.

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