Investment Manager's Report

HISTORICAL PERFORMANCE

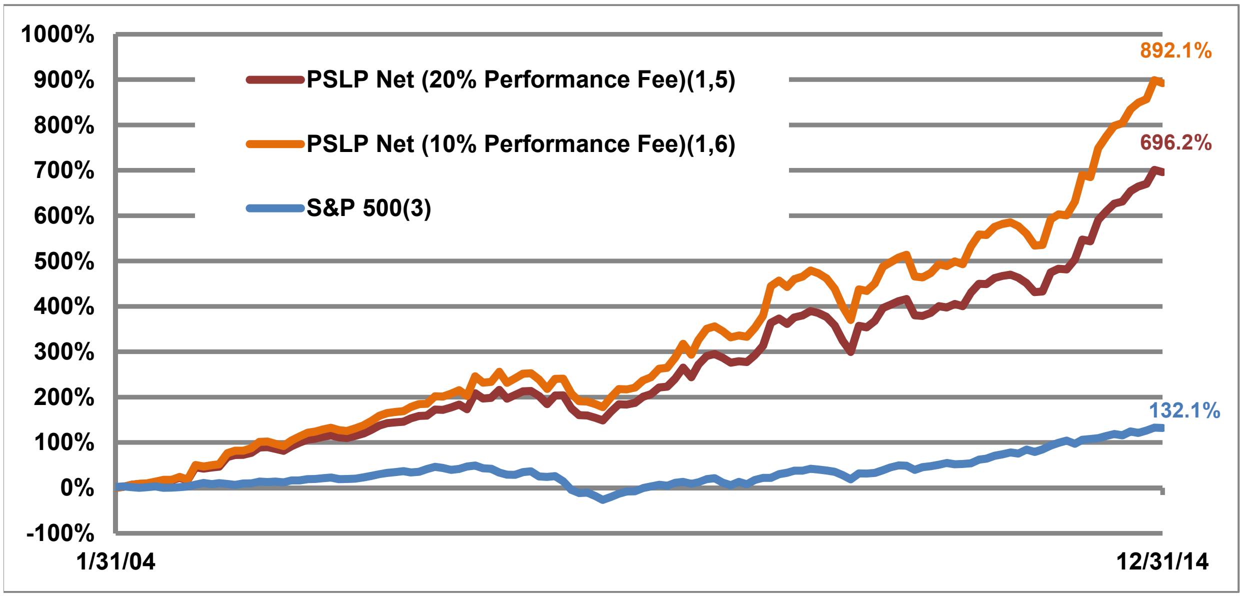
Pershing Square Holdings, Ltd. Performance vs. the S&P 500		
	PSH Net Return [1,2]	**S&P 500[3]**
2013	9.6%	32.4%
2014	40.4%	13.7%
2013 - 2014		
Cumulative (Since Inception)	53.8%	50.4%
Compound Annual Return	24.0%	22.7%

The table below and the chart on the following page reflect the net performance of Pershing Square, L.P., the Pershing Square fund with the longest track record, since inception. We present the Pershing Square, L.P. track record using its historical performance fee of 20% and a 10% performance fee. We used a 10% performance fee as it is what we estimate that the performance fee would be once the Offset Amount (as defined in footnote 2 on page 25) has been paid in full assuming current levels of Company fee-paying assets, and current levels of Pershing Square private funds' fee-paying assets.

Pershing Square, L.P. Performance vs. the S&P 500				
	Net/20% PF [1,5]	**Net/10% PF [1,6]**	**S&P 500[3]**	**Delta Net/10% PF to S&P 500**
2004	42.6%	47.2%	10.9%	36.3%
2005	39.9%	44.9%	4.9%	40.0%
2006	22.5%	25.4%	15.8%	9.6%
2007	22.0%	24.8%	5.5%	19.3%
2008	(13.0)%	(13.0)%	(37.0)%	24.0%
2009	40.6%	43.8%	26.5%	17.3%
2010	29.7%	33.4%	15.1%	18.3%
2011	(1.1)%	(1.1)%	2.1%	(3.2)%
2012	13.3%	14.8%	16.0%	(1.2)%
2013	9.7%	10.9%	32.4%	(21.5)%
2014	36.9%	41.5%	13.7%	27.8%
2004 - 2014				
Cumulative (Since Inception)	696.2%	892.1%	132.1%	760.0%
Compound Annual Return	20.8%	23.2%	8.0%	15.2%

Past performance is not a guarantee of future results. All investments involve risk, including the loss of principal.
Please see accompanying footnotes on page 25.

Pershing Square, L.P. Performance vs. the S&P 500



2014 Key Highlights

PERFORMANCE

Pershing Square Holdings, Ltd. Performance vs. the S&P 500			
	PSH Gross Return [1]	**PSH Net Return [1,2]**	**S&P 500[3]**
2014	50.6%	40.4%	13.7%

PERFORMANCE ATTRIBUTION[4]

Below are the attributions to gross performance of the portfolio of the Company for 2014.

Winners	
Allergan, Inc.	19.1%
Canadian Pacific Railway Limited	7.0%
Herbalife Ltd. (short)	6.1%
Restaurant Brands International Inc.	5.5%
Air Products & Chemicals, Inc.	5.1%
Beam Inc.	2.9%
Platform Specialty Products Corporation	2.7%
Zoetis Inc.	2.2%
The Howard Hughes Corporation	1.2%
Undisclosed Position	0.7%
5 Other Positions	0.6%
Total Winners	53.1%
Total Winners and Losers 2014	**50.6%**

Losers	
Federal National Mortgage Association	(0.6)%
The Procter & Gamble Company	(0.5)%
6 Other Positions	(1.4)%
Total Losers	(2.5)%

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PORTFOLIO UPDATE

Allergan, Inc. (AGN)

In February of 2014, Pershing Square formed a joint venture with Valeant Pharmaceuticals International to pursue a merger between Valeant and Allergan. Allergan is a leading specialty drug company in aesthetics, dermatology and ophthalmology. Over the course of two months, the Pershing Square/Valeant joint venture acquired a 9.7% stake in Allergan at an average cost of $128 per share, which we deemed to be a fair price for the business, assuming no improvement in operations or a transaction.

Allergan had a strong track record of organic growth driven by a portfolio of market-leading products, including the fast-growing Botox franchise, but was not known to allocate capital efficiently or run its business cost effectively. Given the strategic overlap between Valeant and Allergan's product portfolios, along with Valeant's superior cost structure, operating model and capital allocation strategy, we believed that a merger between Valeant and Allergan had the potential to create enormous shareholder value.

On April 22nd, Valeant and Pershing Square announced an unsolicited offer to acquire Allergan for $161 per share, a 38% premium to Allergan's unaffected stock price, and a takeover battle ensued with two price increases, litigation, two proxy contests, a war of words, and ultimately a transaction.

On November 17th, Allergan announced a merger with Actavis plc for cash and stock valued at ~$240 per share when the transaction closed on March 17th. Prior to closing, we hedged a substantial portion of the Actavis shares we would have received while electing to retain 1.35 million shares (held across all funds, ~500,000 are held in PSH) in the newly merged company which we consider to be undervalued and well managed.

Herbalife Ltd. (HLF) Short

We remain confident in our short thesis that HLF is an illegal pyramid scheme that will collapse or otherwise be shut down by regulators. The company's business has continued to deteriorate as reflected by its substantially reduced forward earnings guidance for 2015.

Herbalife is doing its best to attack the messenger with a public relations campaign against Pershing Square. Ultimately, the facts will drive the outcome. We expect continued substantial business deterioration as the company is forced to reform its highly abusive and deceptive practices, or is shut down.

Air Products and Chemicals, Inc. (APD)

Air Products and Chemicals, Inc. has made meaningful progress since Seifi Ghasemi became CEO on July 1st of 2014. We believe that Seifi is the ideal leader to transform Air Products, and we applaud the Air Products Board for hiring Seifi as Chairman/CEO and supporting him in his efforts to improve the company.

Seifi's announced goals are to increase EBIT margins from ~16% to ~22.5%, comparable to that of industry leader Praxair Inc. Air Products expects that half of this 650 basis point improvement will come from SG&A and overhead, and half from gains in productivity and operational efficiencies. Air Products was at the top of the industry two decades ago, and Seifi has stated that he believes there are no structural issues that should prevent the company from regaining its industry-leading performance.

Early results, including earnings announcements in October 2014 and January 2015, have been impressive. Earnings per share (EPS) have increased 13% and 16%, respectively in Seifi's first two quarters as CEO. Operating margins are at the highest levels in nearly a decade, driven partially by reductions in SG&A of ~8% in the most recent quarter. With operating margins now at ~17.5%, Air Products has closed 150 basis points of its margin gap versus Praxair with remarkable rapidity. Air Products' fiscal year 2015 guidance calls for EPS of $6.30-6.55, which represents growth of 10-13% despite foreign exchange headwinds.

Canadian Pacific Railway Limited (CP)

The remarkable transformation of Canadian Pacific continues under the leadership of Hunter Harrison and the reconstituted CP Board in 2014. Full-year EPS grew 32%, in spite of severe winter weather conditions in the first quarter of the year. In 2014, CP achieved an operating ratio of 64.7%, besting its four-year 65% operating ratio target just two years into the operating plan. On an annual basis, CP has risen from the least efficient Class I railroad to the third-best, and the improvements are continuing. This progress has been achieved while maintaining industry-leading safety performance. The drive to operational excellence is enhancing service and reliability, while lowering CP's cost to serve its customers.

In October, CP held an analyst day to outline its revised multi-year plan. The company's new four-year targets call for $10 billion of revenue by 2018, representing a 10.5% compound annual growth rate. This impressive revenue growth is driven by efficiencies and service-level improvements that permit CP to win business for which it historically could not compete.

CP's announced revenue and margin goals translate into about $20 per share in earnings in 2018 including the impact of projected share repurchases. At the inception of our investment in 2011, CP earned $3.15 per share. The achievement of $20 per share in earnings would represent more than a six-fold increase in the earnings power of the business following the proxy contest and Hunter Harrison's appointment as CEO. We believe CP remains an attractive investment led by a superlative management team.

Restaurant Brands International Inc. (RBI)

At the end of August, Burger King announced that it would acquire Tim Hortons, Canada's leading quick-service restaurant (QSR) company, for $12 billion forming the newly renamed Restaurant Brands International (RBI). The transaction closed in December of 2014. Tim Hortons operates a 100% franchised business model with ~4,500 units. In Canada, where 80% of Tim Hortons' restaurants are located, the company commands a market share which RBI estimates to be more than 40% of total QSR traffic and nearly 75% of QSR caffeinated beverages sales.

We believe the acquisition of Tim Hortons will create significant long-term value for RBI shareholders as executed by the company's controlling shareholder, 3G Capital, which has an extremely strong track record of successful business transformations. In the four years that 3G has owned a controlling stake in RBI, the company has dramatically improved its operations, reduced its capital intensity, significantly grown its number of restaurants, and put in place an improved capital structure.

We believe the improvements that 3G has enacted at Burger King will serve as a template to create value in the Tim Hortons transaction. We believe there is substantial unit growth opportunity outside of Canada, and that under 3G's leadership, Tim Hortons is well positioned to identify meaningful operations and capital efficiencies. The acquisition enhances Restaurant Brands' medium and long-term EPS growth rate, and long-term shareholder value.

Platform Specialty Products Corporation (PAH)

We believe that Platform Specialty Products has the opportunity to invest large amounts of capital at a high rate of return by acquiring a portfolio of specialty chemicals businesses that can operate more efficiently as part of a larger industry platform.

Platform's business model of investment in asset-light, high-touch specialty chemical businesses is characterized by high margins, low capital intensity, and high switching-costs. Platform's management team has a demonstrated record of value creation which benefits by an environment which is favorable for M&A activity.

In 2014, the company announced $5 billion in acquisitions in the agricultural chemicals industry by acquiring Chemtura AgroSolutions, Agriphar and Arysta LifeScience Limited. Agricultural chemicals are vital to increased food production, and are a key input to growing crop output to meet the rising demand for food worldwide. Agricultural chemicals have high barriers to entry, both from the need for intensive (and lengthy) research programs and the high hurdle of regulatory approval associated with any input in the food chain. With these acquisitions, we believe that Platform has assembled a leading global crop solutions business that offers a full product portfolio and diversity across crop varieties and geographies.

Zoetis Inc. (ZTS)

In November, Pershing Square announced an 8.5% stake in Zoetis, the world leader in branded animal healthcare products. Until 2013, Zoetis was a non-core subsidiary of Pfizer, whose primary business is human healthcare products. In January 2013, Pfizer completed an initial public offering of a 20% stake in Zoetis. The separation from Pfizer was completed in June 2013, when Pfizer split off its remaining 80% ownership to its shareholders.

The separation resulted in the creation of the only large, independent, publicly traded animal health company in the world. The company has a market capitalization of ~$24 billion and ~$5 billion in revenue.

Zoetis' business model passes our high bar for business quality. Zoetis participates in markets with strong secular growth, driven by global increases in protein consumption, pet ownership, and the use of medicines to treat pets and livestock. As a result, the global animal health market has grown at an average of about 4% since 2008 and has experienced positive volume growth every year since 2003. Historically, Zoetis' organic growth has exceeded the industry average.

Zoetis' animal healthcare portfolio is highly durable. In 2014, ~80% of Zoetis' revenue was derived from products that are not patent protected. Rather than rely on patents, which have a finite life, Zoetis' business is driven by brand, market position, customer relationships and service, and other durable factors which have led to long product lifecycles.

One of the most important factors which contribute to the durability of Zoetis' products is the small size of animal health products. Only about 20 products in the industry have sales exceeding $100 million, with the majority of products having sales significantly below this level. Gross margins of branded animal health products are lower than branded human health products. This combination of smaller products and lower gross margins has made it difficult for generic manufacturers to compete in the animal health market.

We have had a very positive dialogue with the board and management of the company. In February of 2015, Bill Doyle from our investment team joined the Zoetis Board of Directors. We expect the company to add an additional director shortly. We look forward to working with the board and management as a long-term shareholder of Zoetis.

The Howard Hughes Corporation (HHC)

A little more than four years ago on November 10, 2010, HHC became a public company in a spinoff from General Growth Properties. At the time, there was considerable skepticism about the orphaned development assets that comprised HHC's asset base. This was reflected in the company's share price which closed at $36.90 that day. Since its launch as a public company shareholders have been rewarded with a four-fold increase in the company's stock price.

In a short period of time, management designed and launched development or monetization plans for each of the company's assets. HHC continues to create value converting its development-stage assets and vacant land into income-producing real estate and high-rise residential condominiums held for sale. We have not before seen a real estate company accomplish so much in so little time while maintaining superbly high quality execution along the way. Credit for this progress belongs to the extraordinary management team at HHC that is led by CEO David Weinreb and President Grant Herlitz, and a highly shareholder-oriented, real-estate-savvy board of directors.

While the stock declined at the end of 2014 due to concerns about the decline in energy prices and its impact on the Houston assets held by the company, we viewed the market reaction as overdone and temporary. Since the beginning of 2015, the stock price has returned to near its all-time high.

We believe that HHC is well positioned to benefit from the housing recovery, and that over time, the intrinsic value of HHC will be easier for investors to assess as the company's cash generation from stabilized income-producing assets increases.

Fannie Mae (FNMA) / Freddie Mac (FMCC)

Fannie Mae and Freddie Mac remain a critical piece of the U.S. mortgage market and we expect will serve as a core driver of the continuing housing recovery. In spite of much rhetoric about the desirability of replacing and shutting down Fannie and Freddie, we believe that there is no credible alternative to replace them. Consumers in the U.S. benefit enormously from the existence of the 30-year, prepayable, fixed-rate mortgage. As a result, we believe that Fannie and Freddie's role is fundamental to the economy, and that ultimately, a renewed and recapitalized Fannie and Freddie is a far better alternative to any other.

Beginning in 2013, the U.S. Government began stripping all profits from Fannie and Freddie and sending them to the Treasury every quarter, in perpetuity. The Treasury unilaterally amended the 10% dividend rate on its senior preferred stock to a variable dividend equal to 100% of Fannie and Freddie's future earnings and existing net worth. We view this net worth sweep as an unlawful taking of shareholders' private property, and brought suit in District Court and in the U.S. Court of Federal Claims on behalf of common and preferred shareholders.

In September of 2014, the U.S. District Court for the District of Columbia dismissed shareholder lawsuits seeking to enjoin the net worth sweep undertaking by the government. We believe that much of the U.S. District Court ruling may ultimately be overturned on appeal.

The adverse court ruling resulted in a large decline in Fannie and Freddie's respective share prices, which we used as an opportunity to purchase additional shares in both companies. We voluntarily withdrew our case in the U.S. District Court and are devoting our legal resources to reversing the Federal Government's improper seizure of common shareholders' property by prosecuting our Constitutional takings claims in the U.S. Court of Federal Claims.

In addition to our belief that the net worth sweep constitutes an unlawful taking under the U.S. Constitution, we believe that it is an untenable economic arrangement. By stripping Fannie and Freddie of the earnings that they could otherwise use to build capital, the Treasury is subjecting the U.S. taxpayer to grave risk during the next economic downturn.

We remain convinced that a reformed Fannie and Freddie is the only credible path to preserving widespread access to the 30-year, prepayable, fixed-rate mortgage at a reasonable cost. It is therefore essential that Fannie and Freddie build a sufficient level of capital through the retention of their earnings so they can continue to perform their vital function in the mortgage markets while limiting risk to the U.S. taxpayer. A reformed and well-capitalized Fannie and Freddie will accomplish the important policy objective of providing widespread and affordable access to mortgage credit for millions of Americans while, at the same time, delivering tremendous economic value to the U.S. taxpayer through Treasury's ownership of warrants on 79.9% of Fannie and Freddie's common stock.

While we remain confident in the prospects for Fannie and Freddie and believe our investment in their common shares will ultimately be worth a large multiple of current prices, the litigation is likely to continue for a protracted period before being resolved, unless the Administration, Treasury, Congress and other interested parties forge a consensual resolution. In light of the inherent uncertainty of the situation, our combined investment in the two companies represents about 3% of our capital at current market values.

Exited Positions

During 2014, we exited our positions in Beam Inc. through a sale to Suntory Holdings, General Growth Properties, Inc. in a share sale to the company, and Procter & Gamble through open market sales.

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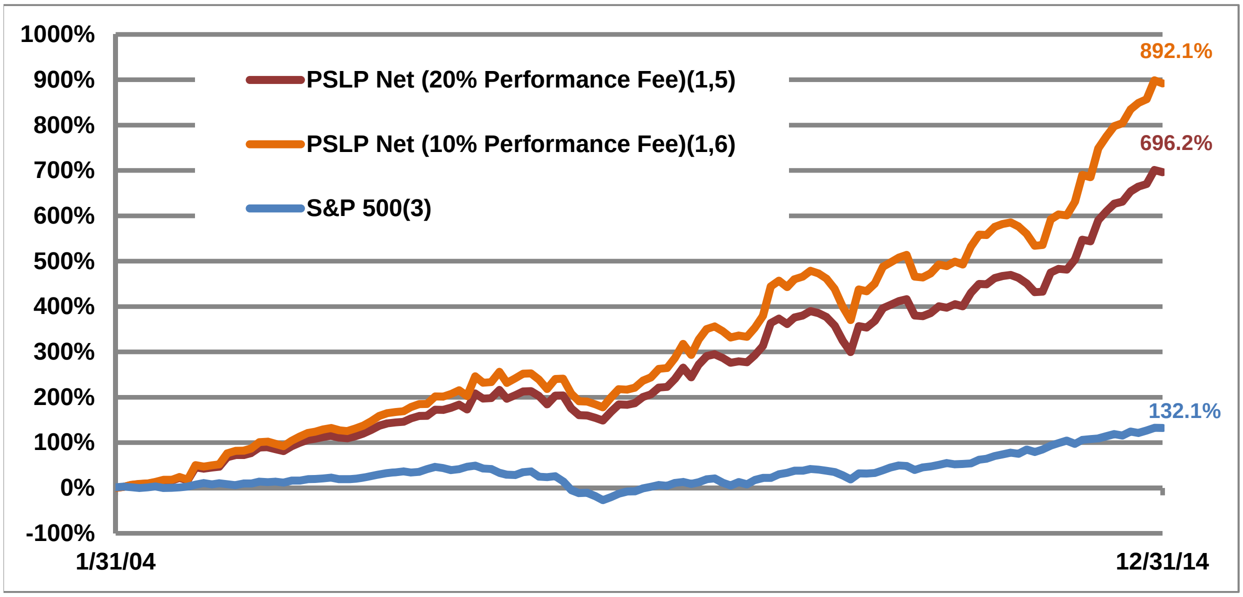

PUBLIC ACTIVIST INVESTMENTS SINCE INCEPTION[(7)]

Below are all of the companies to date, both long and short, in which Pershing Square has taken a public, active role in seeking to effectuate change.

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LETTER TO SHAREHOLDERS

Dear Shareholder:

As this is the first annual letter that will be read by the public Pershing Square Holdings, Ltd. investors as well as one that is read by investors who have been our partners for years, I thought it would be useful to provide an overview of our strategy as it has developed over the last eleven years.

In preparation for writing this letter, I re-read our investor letters since inception and highlighted the sections which I thought would be most useful to an understanding of Pershing Square. I often read the annual reports of companies in which we invest for the ten or more years preceding our investment as a way to understand the progress of a company and its strategy. To save you the effort of doing so for Pershing Square, later in this report, I have included excerpts from our previous letters organized by topic. Re-reading our investor letters was a useful exercise in that it has enabled me to better understand the development of our strategy over time.

While the core of our investment strategy remains unchanged, the growth of the firm, our increasing "reputational equity," expanded relationships and experience have enabled us to intervene as an active investor differently from our approach in the past. In Pershing Square 1.0, we took substantial stakes and pushed for corporate changes which we believed would create shareholder value. Our holding periods were shorter. We achieved high rates of return, but required constant recycling of capital into new ideas. The changes we advocated were more structural and corporate than managerial and operating – think Wendy's spinning off Tim Hortons, or Ceridian being sold to private equity.[8] We proposed change from outside the board room as we did not generally become a member of the boards of target companies.

In retrospect, the development of our investment in General Growth Properties (GGP) represents the inception of Pershing Square 2.0. In GGP, I joined my first board since the inception of Pershing Square, more than five years after we launched the firm. At the inception of our GGP investment, our original strategy was a financial restructuring of the company in bankruptcy. From the perspective of the board of directors, we identified additional opportunities to create value which led to a recapitalization of GGP along with a change in management which we played a role in identifying.

It was the creation of The Howard Hughes Corporation (HHC) – which began as a spinoff of unrelated assets or businesses to unlock value – where we chose to take a much deeper approach. Unlike Tim Hortons, HHC did not actually exist at the time of our investment in GGP. We created HHC by assembling a pool of unrelated assets from GGP as a means to unlock the value of these principally non-income producing assets. Unlike in Wendy's where we were advocating for the Tim Hortons spinoff from outside the boardroom, with HHC, we had the benefit and the responsibility of seeing it through.

By going beyond a financial restructuring and getting deeper into the creation of a new board and in the recruitment of management, we recognized the potential for greater board oversight to create substantial longer-term value for Pershing Square and other stakeholders. HHC was not part of our original plan at the time of our initial investment in GGP. Since we created HHC from idea to launch, we had to help build a board of directors. As the largest stakeholder with more than a 25% stake in the new spinoff company, we ended up with the right to appoint one third of the board.

With these attributes came responsibility. I became chairman of HHC because there was no one else logical to serve in this role. We then hired a new management team led by David Weinreb and Grant Herlitz. While we had input into GGP's new management team – we recommended Sandeep Mathrani for the job – at HHC, we identified and recruited the team and designed their compensation.

In retrospect, the transition from Pershing Square 1.0 to 2.0 was unplanned and largely organic. Our involvement with HHC led us to other deep engagements at J.C. Penney, Justice Holdings/Burger King (now Restaurant Brands International), Canadian Pacific, Air Products, Platform Specialty Products, and Zoetis. With one disappointing exception, J.C. Penney, Pershing Square 2.0's track record of board engagements has been extremely strong. While our degree of engagement has varied, the approach is similar. Find a great business where there is an opportunity for management, operational, and/or governance improvements. Build a large stake at an attractive price. Work with management and the board to make necessary changes. Seek board representation for members of the Pershing Square team or affiliated or independent representatives that we identify.

While we give up some flexibility when joining a board, we have found that managements, boards, and Pershing Square benefit by our being present in the board room. CEOs often tell us that our involvement enables them to accelerate initiatives that they had previously advocated, but that the historic board was tentative about making out of concern with what the shareholders might think. With a large – and often the largest – shareholder represented on the board, who typically has the support of the majority of other owners, boards become more comfortable accelerating necessary change or making substantial new investments or acquisitions because they already have a shareholder sounding board in the board room.

As our typical investments today incorporate both structural and operational improvements, they offer more levers to create value. The combination of these initiatives has enabled us to earn larger multiples of capital over longer holding periods. GGP, which we recently exited, is the best and perhaps most extreme example. Our three current longest-standing holdings, HHC, CP, and Restaurant Brands have each appreciated multiple times since our initial investment. The balance of these commitments – Air Products, Platform Specialty Products, and Zoetis – are all off to strong starts since we got involved.

We do not believe it is necessary for us to have a board seat in these commitments if we are confident that the existing board already has appropriate shareholder representation, and a management team with exceptional operating and capital allocation discipline. Restaurant Brands, which is controlled by 3G, is a good such example. While the bulk of our capital is invested in Pershing Square 2.0-like commitments, we are still open to shorter-term commitments if the opportunity for profit relative to risk is large enough.

The benefits to our transition from Pershing Square 1.0 to 2.0 are significant. With reduced turnover in the portfolio, we can better understand our investments, reduce frictional costs, and continue to achieve high rates of return. Our reputational equity is also enhanced because as a longer-term investor, our recommendations for corporate change are more welcomed by the companies in which we invest and the major shareholders who own them.

Longer-term investing in high quality businesses is also more scalable than Pershing Square 1.0's strategy. Once we are in a position of influence and own a high quality business run by able management who manages the business well and allocates free cash flow intelligently, absent excessive overvaluation or a substantially better use of capital, there are few good reasons to sell. It is essential though that these commitments have all of the above: high business quality, managerial and operating talent, and intelligent capital allocation for them to continue to generate high rates of return over the long term.

We believe that one of the biggest threats to the strategy has been the open-ended nature of our capital base. With the launch and increasing scale of PSH and a growing base of employee capital, our effective permanent capital base is quickly approaching a majority of our capital. When this is combined with loyal investors, relatively long-term contractual commitments in the private funds, and an active investor relations program, our capital base approaches the ideal of permanency. We took advantage of this increased permanency by being nearly 100% invested in our core activist strategy beginning last year. Our 2014 results benefited from not being diluted by our historic need to keep a large pool of assets in cash and liquid passive investments. We expect that the growing stability of our capital will continue to be an enormous competitive advantage for the strategy and for Pershing Square.

2014 was one of the strongest years in our history as measured by performance, net dollars of profits generated, as well as developments with respect to existing holdings and a new investment which should generate profits in future years. For a detailed review of the portfolio during 2014, please refer to the PSCM Annual Investor Update which is available on the Company's website.

The IPO of Pershing Square Holdings was perhaps the most significant accomplishment of 2014 in light of its material strategic long-term benefits to our investment approach. None of 2014's accomplishments could have been achieved without extraordinary contributions from every member of the Pershing Square team. Our finance, accounting, investor relations, legal and compliance, administrative, technology, and investment teams committed an enormous amount of time, insight, and energy to the IPO and listing of Pershing Square Holdings while simultaneously being responsible for their day jobs running the operations and investment oversight functions of Pershing Square.

Eleven years after our launch, the Pershing Square organization is functioning at its highest level of effectiveness ever. This is partly due to our extremely low turnover and the fact that most of us have worked together for more than five years and many of us for substantially longer. We are proud of our friendly, open, hard-working and family-oriented culture that has contributed greatly to our success, and that we have worked hard to preserve as the organization has grown. Long-term, our culture is likely to continue to be a key competitive advantage for the firm.

Over the next 10 or so pages, I have excerpted sections from the Pershing Square letters from inception to the present that cover our business model, investment strategy, risk management, valuation, hedging, trading, investor relations, and other topics that would be of interest to a new investor in Pershing Square. These excerpts are cited as originally written with any updates reflected within end brackets. You will note that there are *de minimis* updates, as even a decade later, our investment principles and philosophy are largely unchanged.

For new Pershing Square investors, we hope you find these principles useful in understanding what to expect from us going forward. For our longer-term investors, you may find the thoughts on the attached pages to be a helpful reminder of the key elements of our strategy.

As always, we encourage you to contact the investor relations team at IR-pershingsquareholdings@stockwellgroup.com if you have any questions.

Sincerely,

William A. Ackman

PERSHING SQUARE PRINCIPLES

The Pershing Square Business Model

In order to achieve long-term success, Pershing Square must make good investments and operate with a robust business model. With much media attention focused on hedge fund failures, I thought it would be worthwhile reviewing the characteristics of our business model and explaining why we will withstand industry-specific and overall environmental threats to the investment and hedge fund businesses. The principal factors which contribute to the robustness of our business model are as follows:

- Our portfolio management approach is inherently low risk (where risk is defined as the probability of a permanent loss of capital), particularly when compared with other hedge fund business models. An important distinguishing factor about Pershing Square compared to most other hedge funds is that we do not generally use margin leverage in our investment strategy. The lawyers prefer that I put in the word "generally" to give us the flexibility to use margin to manage short-term capital flows, but, to-date, we have not used but an immaterial amount of margin, and only for a brief period of time, and we have no intention of changing this approach.
- We generally invest in higher quality businesses with dominant and defensive market positions that generate predictable free cash flow streams and that have modestly or negatively leveraged (cash in excess of debt) balance sheets. We buy these businesses at deep discounts to our estimate of intrinsic value giving us a margin of safety against a permanent impairment of capital. I say "generally" again here because we do make exceptions in certain limited circumstances; that is, we may buy a more leveraged or lower quality business if we believe the price paid sufficiently discounts the risk.
- We often seek investments where we can effectuate positive change to catalyze the realization of value. This serves to accelerate the recognition of value, helps us avoid "dead money" situations, and protects us somewhat from managerial actions which can destroy value.
- We are diversified to an adequate but not excessive extent. This has further benefits for risk and operational management which I will discuss below.
- There is an inherent balance to our long/short investment approach. Historically, when equity or credit markets weaken, our shorts become more valuable, and occasionally materially more valuable, offsetting somewhat the mark-to-market declines in our long portfolio. If we choose to unwind these short positions during market downturns, we can generate capital to invest in a now less expensive market. These short investments generally stand on their own in that they do not typically require a stock market or credit market decline to be successful. That said, they have served as a useful hedging tool during periods of dramatic market declines.
- We have been paranoid about counterparty risk since the inception of the firm. First, we trade with counterparties which we believe to be creditworthy. Second, we have negotiated ISDA agreements which provide us with daily mark-to-market cash and U.S. Treasurys equal to the previous day's market value of our derivative contracts [in excess of certain minimum thresholds]. In cases where we are required to post initial margin and therefore have some exposure beyond the market value of our derivative contracts, we have typically purchased CDS on our counterparties to further mitigate counterparty risk. While our approach to counterparty risk has protected us from any counterparty losses to date, please be forewarned there is no perfect approach to avoiding counterparty risk.

Our Approach to Risk Management

Our simple approach to investing also allows us to avoid complicated approaches to risk management. Our investment strategy does not require us to open offices all over the globe. As such, we don't need traders working around the clock. We can go to sleep at night and sleep. Our weekends are largely our own. Our risk management approach is to: (1) put our eggs in a few very sturdy baskets, (2) store those baskets in very safe places where they cannot be taken away from us and sold at precisely the wrong time due to margin calls, and (3) to know and track those baskets and their contents very carefully. We call this approach the sleep-at-night approach to risk management. If I can't, we won't.

I am extremely skeptical of more automated, algorithmic, Value at Risk, and other business school sanctioned approaches to risk management. None of these approaches saved Lehman, Bear Stearns, Fannie, Freddie, AIG, WaMu, Wachovia or any of the other institutions that used these and other ostensibly more sophisticated risk management strategies.

Our investment strategy and approach to counterparty risk serves to limit the risks inherent in our individual investment selections, our counterparty risk, and the portfolio as a whole. There are, however, other important risks to our business, principally operational, reputational, and regulatory risk.

Operational Risk

Our investment approach is largely straightforward and relatively simple. This, coupled with the concentrated nature of the portfolio, allows us to run our business with a limited number of personnel. We have [ten] investment professionals including myself.

We could manage our portfolio with less human talent than we have. For members of the investment team reading this letter, don't be concerned because I have no intention of shrinking the team, but I make the point nonetheless. Simplicity in our investment approach allows for a simpler back office and a smaller overall staff. We have [70] people total at Pershing Square. It could be fewer, but one of Tim Barefield's (our COO) important risk management principles provides for back-up talent for every role in the firm.

Our Noah's Ark approach to personnel duplication makes for a good analogy for the ship we have designed. We have worked hard to build a business that can withstand the Great Deluge, and this goes beyond counterparty risk. For example, it is not yet clear this year whether there will be any incentive allocation to be shared at the firm. [This excerpt was from November 3, 2008] That said, whether or not the funds' finish the year in the black, it will be extremely unlikely that a member of our team leaves by choice, and I have no intention of letting anyone go. This is due to several factors:

Pershing Square's large amount of assets under management per investment principal and per overall employee are important ratios to consider when evaluating the sustainability of Pershing Square or any hedge fund for that matter. The economics of a high-asset-per-employee ratio attract and allow for the retention of top talent. Our team can be compensated appropriately even in times of short-term underperformance. Hedge funds which barely (or don't even) cover their costs with management fees are inherently unstable enterprises because in an unprofitable year they cannot pay their people and are likely to lose their most talented professionals to other firms.

Pershing Square is a nice place to work. While this sounds like an obvious approach to retaining talent, many and perhaps most hedge funds don't fit this description. We are big believers in taking care of our team not just financially and with attractive benefits, and we have those in spades. We consider every employee at the firm a member of our extended family, and we treat and care for them appropriately. We do this not for business reasons, but it has important long-term business benefits.

Pershing Square is an extremely exciting place to work. We believe our work creates value beyond the profits we historically have generated for our investors. Our approach to value creation at businesses has created enormous value for investors who happened to own companies to which we contributed to the creation of value. Similarly, investors and counterparties who listened to our views on the bond insurers, Fannie Mae and Freddie Mac, etc. saved themselves from large losses or perhaps profited by short sales. The fact that our work creates value for the markets as a whole provides additional motivation to the team.

Bottom line, we are built to last, and we will continue to work hard to deserve your continued support.

Reputational and Regulatory Risk

Reputational risk is one of the key risk factors for a business that is subject to a high degree of regulatory scrutiny in an industry that seems to generate considerable public scorn. Our approach to assessing reputational risk is to apply the New York Times test. We ask ourselves whether we would be comfortable having our family and friends read a front page New York Times story about actions taken by Pershing Square written by a knowledgeable and intelligent reporter who has access to all of the facts. If we are comfortable with such an article being read by our close friends, our families, and the public at large, our action passes the test. If not, we reconsider our potential action.

Concentration and Volatility

Our investment policy of concentration will lead to volatile and eccentric results particularly in the short term. As a result, we will likely have months, quarters, and years where we will underperform the market benchmarks and our long-term expected rates of return.

We believe, however, that while [the funds] are at greater risk of underperformance during short-term periods and are likely to be substantially more volatile than less concentrated strategies, our approach has the strongest probability of leading to high long-term levels of investment performance over a three to five-year measuring period.

Pershing Square's performance over the long term will primarily be a function of the equity investments we make on a security-by-security basis – principally as long investors and less so as short sellers. As you know, our holdings are concentrated so our performance will likely be more volatile than that of investors who are more diversified.

There are also likely to be periods during which our performance dramatically exceeds or greatly underperforms stock market indexes. We are willing to endure a high degree of stock price and portfolio volatility because we believe it allows us to achieve a greater degree of investment performance over the long term. We believe that this strategy is appropriately matched to the long-term capital we and our investors have committed to the funds.

In light of the high degree of concentration of the fund, you should expect a similar degree of concentration in our performance. That is, our top few ideas should contribute the majority of our profits for the year. If we can avoid significant losses and have a few good successes each year, you will likely be happy with the results.

Risk of Permanent Loss of Capital and Investment Sizing

The substantial majority of the portfolio has been invested in large and mid-capitalization North American listed equities, often with catalysts to unlock value, at times situations where Pershing Square can be the catalyst. Because these investments tend to be well-capitalized dominant business franchises that have been acquired at discounted valuations, we believe the risk of permanent loss of capital in these situations is limited.

We have historically also invested in other investments that have materially different risk and reward characteristics. These investments – because of the circumstances surrounding the companies at the time of our investment, the highly leveraged nature of the businesses or assets, the relative illiquidity of the investment, and/or the structure of our investment – have a materially greater likelihood of a potential permanent loss of capital for the funds. In light of this greater risk, we require the potential for a materially greater reward if we are successful, and we size the investments appropriately. Depending upon the risk of loss, these investments may individually comprise a few percent or less of capital, and often less than one percent of the portfolio.

On Retaining the Option to Abandon

I consider one of our investment strengths to be our willingness to promptly change our mind when confronted with new information which is inconsistent with our original investment thesis. I have learned from prior experience that sometimes the better part of valor in an investment situation is to move on.

Long Investments

As a general rule, we purchase simple, predictable, free-cash-flow generative businesses that have sustainable competitive advantages due to brand power, unique assets, long-term contractual arrangements, or other factors. These companies are [generally] modestly or negatively leveraged (i.e., have more cash than debt) and do not need access to the capital markets to survive and thrive. These businesses generate more capital than they need for reinvestment. They deploy this excess capital by buying back their own shares and by paying dividends to shareholders.

As a result of the above characteristics, the intrinsic value of the businesses that we own is relatively immune to equity and credit market volatility. They [generally] do not have large debts that need to be refinanced. They [generally] do not need to raise equity capital to continue to exist or even to grow. Because these companies are buyers of their own shares, we are actually the beneficiaries of short-term declines in their share prices because more shares can be repurchased in the market with the same amount of capital. Our proportionate interest in these companies will grow at a higher rate if their stocks decline than if their share prices were to have risen over the same period.

Because these businesses have superior economic characteristics and limited or negative financial leverage, I would expect our long investments, on average, to decline less than the market as a whole in a dramatic market decline. The stock prices of our investments, however, are still likely to decline during periods of equity market declines unless specific value-creating events occur that will cause a realization of value.

Pershing's investment strategy requires us to identify investments for which we can determine their outcome with a very high degree of probability. As a result, we typically invest in businesses with low business volatility and a high degree of cash flow predictability.

As an investor who has successfully effectuated corporate change and as typically one of the largest holders of the companies in which we invest, we are well positioned to push for value-creating actions in the event such opportunities are created in volatile markets.

For obvious reasons, we much prefer that a stock price declines while we are acquiring our interest for it enables us to buy a full position at a lower price. While we don't automatically buy more if the share prices of our holdings decline, it is the rare circumstance where an existing holding's stock price declines meaningfully and we are not excited to take advantage of the opportunity. This is true because the businesses in which we generally choose to invest are those whose values are not materially affected by extrinsic factors we cannot control. While nearly every one of our investments is exposed to the economy to some degree, we attempt to identify companies for which increases or decreases in interest rates, commodity prices, short-term volatility in the economy, and similar factors are not particularly material to our investment thesis.

Long Exposure and Market Correlation

Our greater long equity exposure means that we are likely to have greater daily correlation with short-term moves in the market than if we had less exposure. Over longer periods, we expect our portfolio to continue its high degree of divergence from overall stock market performance because of the high degree of concentration in our holdings and the event-driven nature of most of our investments.

While a more positive macro environment will increase the value of our holdings, we expect to generate high long-term rates of return from our existing holdings even without a substantial improvement in the economy. I have come to think of our investment approach as akin to a form of long-term arbitrage, where we invest and then work with our portfolio companies to cause the spread between our purchase price and intrinsic value to narrow. In some cases, in addition to unlocking existing value, we can assist a company in increasing its long-term intrinsic value by bringing in new management, adopting a change in strategy, modifying its structure and approach to allocating capital, by selling or spinning off non-core assets, through cost control and with other approaches.

Our ability to cause the price-value spread to narrow is, in most cases, unrelated to macro events, and has improved significantly over the last [eleven] years. It is largely a function of Pershing Square's growing influence in the capital markets, our experience with previous investments, and specific circumstances with each of our holdings.

Short Selling

While our shorts in [some] previous years reduced our performance largely on a mark-to-market basis, the drag on fund performance was [generally] small when compared with our absolute performance. While our short investments are designed to enable us to profit from security-specific opportunities, they have the important additional benefit of hedging our long investments, which typically have some degree of economic sensitivity. Our shorts are also a source of liquidity in dramatic market downturns.

Our favorite short opportunities are companies that are highly leveraged, need access to capital to survive, require substantial management judgment in the determination of their reported earnings, and have fundamentally bad business models. These criteria have led us to short investments in the financial service industry, principally insurance or credit guarantee businesses. For equity shorts, we have an additional criterion which requires that there is a "ceiling on valuation." A ceiling on valuation is what we deem to be the equivalent of a margin of safety for long investments. In other words, we look for equity shorts where the conventional bounds of valuation for a particular business protect us from material stock price increases.

Because it is difficult to identify opportunities with the above criteria, you should expect that we will find few short investments over time, certainly when compared with long opportunities. That said, when we find interesting shorts, we can often make these positions quite large using CDS while taking minimal risk of the loss of a material amount of fund capital.

We find the purchase of CDS to be a far superior means to implement a short sale when compared with shorting stock because of the modest risk incurred versus the potential reward. While our risk in purchasing CDS is limited to modest premium payments, the reward is potentially many times the capital that we risk. CDS positions can be built in enormous size, usually substantially larger than that of equity shorts. We have [historically] found the degree of liquidity available in CDS to be ample for us to execute and realize our investments. By comparison, shorting stocks requires us to borrow shares which can often be in limited supply, require the payment of substantial borrowing costs, and are at risk of being called away at inopportune times. For the above reasons, you should expect most of our notional short exposure to be executed through CDS rather than equity shorts. For those of you who are less familiar with CDS, below I provide a brief primer on CDS.

CDS contracts are best described as multi-year insurance policies which pay off when a company defaults on its obligations. These contracts trade in the over-the-counter market and are priced on a minute-by-minute basis based on the market's estimate of the probability of default of the issuer referenced in the CDS contract.

The degree of risk associated with CDS largely depends on which side of the contract the counterparty is exposed. The seller of the contract is the insurer and the buyer is the insured. We have only been a buyer of CDS contracts (or a seller of contracts we already own), which means that we commit to pay quarterly premiums for the full term of the CDS contract which can typically range from one to ten years. Our maximum exposure in a CDS contract is the present value of these future contractual premium payments. Our maximum potential for gain is the face value or notional amount of the contract. By contrast, the risk to the seller of CDS is the notional amount of the contract or, in insurance terms, the face amount of the policy.

Mispriced Probabilistic Investments

Investing is a probabilistic business. For every commitment of capital we make, we compare our estimation of the likelihood of success with the probability of failure. We then assess how much we can make in a successful outcome with our best estimate of what we can lose in an unsuccessful outcome. We are willing to take more risk in a situation that offers more reward.

While most of our long investments are comprised of great businesses or assets at fair prices with a catalyst to create value, we occasionally are willing to invest a small amount of fund capital in situations which offer the potential for a many-fold profit at the risk of a large or near-total loss of capital invested. I typically call these investments mispriced options. Our CDS investments fit this profile. While not all mispriced options will be profitable for the funds, I expect our collective experience in these commitments to be quite favorable over time.

Valuation

We believe the value of a business is equal to the present value of the cash the business generates for its owner over its lifespan. By analogy to debt instruments, a business is like a bond where the owner will receive a stream of coupons over its life, but where the coupons are variable and not precisely known, and the business' life or term is similarly uncertain. To value a business, one needs to predict approximately how much cash the business will generate that can be distributed to its owners over its life on a per-share basis. I emphasize 'per share' because dilution from option issuance or from ill-advised acquisitions – or, conversely, accretion from stock buybacks – can have a very material impact on the long-term, per-share value created for owners.

Because of the inherent uncertainty in valuing bonds with unknown coupons and terms, we have generally chosen to invest in businesses where the coupons (the economic earnings) are more predictable, and the long-term prospects are more certain. This has led us to purchase interests in simple, predictable, free-cash-flow-generative businesses. We also require a purchase price which represents a large discount to our estimate of intrinsic value. This, perhaps more than anything, helps mitigate the risk of our being wrong about our future estimate of a business' performance.

Management and governance can have a big impact on the per-share prospects of even the best businesses, and an even greater impact on lower-quality businesses. This has led us to purchase higher-quality businesses when we can find them at prices that make sense. The importance of good governance and management to a successful investment outcome is made particularly clear when the cash flows to the owners of a business are back-end loaded. The majority of the cash generated by most publicly traded businesses is not distributed to their owners in the short term. Cash returned to owners in the form of dividends and stock buybacks usually represent a minority of the cash generated by the business, with the balance of a business' cash often reinvested in new projects or acquisitions.

As a shareholder willing and able to take a pro-active or re-active stance with respect to our holdings, we can help mitigate the risk of poor governance and the inefficient use of excess cash by having an impact on both management and governance. While we can have significant influence, we cannot completely eliminate poor investment or management decisions. As a large influential shareholder, we can also often play a meaningful role in determining when the equity "bond" comes due. For example, if it makes sense for a business to be sold because it has reached the end of its strategic life, or because management cannot be identified to maximize the value of a business, or because the greatest long-term value can be generated through a sale, we can meaningfully increase the probability that a sale can be executed.

Hedging

We have never managed the funds to be so-called "market neutral," nor have we attempted to mitigate (or take advantage of) the funds' exposure to short-term market movements because we do not believe we have a competitive advantage in doing so. Rather, we invest our capital in a small number of situations which we believe have modest downside risk and substantial opportunities for profit. The modest downside risk comes from: (1) the identification of high quality businesses that are relatively immune to short-term macro factors and other extrinsic risks outside of our control, and (2) the fact that we have purchased our investments at prices which we believe to be a substantial discount to our assessment of intrinsic value. In addition, many of our investments have specific catalysts to unlock value – progress through bankruptcy, changes to capital structures, operating enhancements, a sale to a strategic buyer, and others – that make them somewhat less sensitive to overall stock market movements. Even so, if the stock market were suddenly to decline substantially, most of our long investments would likely decline in value.

While some hedge fund investors mitigate their (often large) gross exposures through offsetting short positions that equal or approach the size of their long portfolio and result in a low net exposure, this is not an approach with which we are comfortable. Despite our substantial net long exposure since inception, we have been able to generate high returns with modest downward volatility because of the inherent balance in our portfolio: The substantial majority of our assets are typically invested in high quality, well-capitalized businesses at substantial discounts to intrinsic value with catalysts for value creation. These long investments are [occasionally] balanced by short positions, principally expressed through credit default swaps, in high-risk, highly leveraged enterprises often with aggressive and/or fraudulent accounting and bad business models.

Hedging Instruments

While we make no attempt to manage short-term volatility in our performance, we have always sought to identify investments from which we will profit in the event of dramatic downward moves in the stock or credit markets. For this category of investments or hedges, our strong preference is for situations where we risk only a modest amount of capital in exchange for a large payoff should the event take place, and a potential total loss of the capital invested in the event it does not take place. Because of the limited amount of our capital that we expose to these commitments, the cost of such a hedging program in the last few years has been a small drag on our performance, with the risk limited to the modest amount of capital invested in these strategies. Viewed in its entirety, however, this investment program has generated enormous net returns for the funds largely due to profits from credit default swaps (CDS) in 2007 through 2009.

For the first five years of our existence, we purchased large amounts of CDS on single-name credits or the investment grade indexes to perform this function. CDS were an ideal form of disaster protection because we were able to identify credits whose ratings or perceived creditworthiness were much greater than the reality. As a consequence, we could short credits on which we expected to profit as the market eventually reassessed their creditworthiness, when credit events took place, or when stocks and bonds generally declined in value. These were ideal hedges, as the best and least costly hedge is one which you would purchase as a standalone investment without regard to its hedging benefits, but one which also is likely to increase in value dramatically at times of market stress.

We have been unable to identify large single-name, standalone CDS investments since 2009. This is largely due to the rapid improvement in corporate creditworthiness over the last [six] years.

Asymmetry in Hedging and Investing

Since the inception of the funds, we have purchased options which offer asymmetric payoffs in the event of the occurrence of low-probability catastrophic or otherwise unanticipated negative events. These events could include large movements in interest rates, currencies, or other asset prices that we believe may occur during periods of market stress. Most of the options that we have purchased that fit this description have historically expired worthless. You have not noticed these losses because the size of these commitments has been immaterial.

We have committed capital to these investments because of the potential hedging benefits they offer, and also, in certain cases, because we believe the pricing of the instruments understates the expected value of the payoff event. For each of these investments, the payoffs have historically been zero or nominal unless there is a large movement in the underlying instrument, which is only likely to occur during periods of extraordinary market stress. As such, they are not likely to protect the funds from other than very large market declines, and even then there is no guarantee that they will serve their desired function.

We have also made asymmetric investments which are not for hedging purposes but which also offer large payoffs on relatively modest commitments of capital where we similarly believe that the market has mispriced the probability of a positive outcome. In some cases, as with GGP, we were able to buy common stock for less than a dollar per share because the probability of a recovery for shareholders was correctly perceived to be *de minimis*, but where our active intervention could meaningfully tilt the probability of a successful outcome in our favor.

The Impact of Macro Factors on Our Investment Selection

Despite the fact that we occasionally have an opinion, we spend little time trying to outguess market prognosticators about the short-term future of the markets or the economy for the purpose of deciding whether or not to invest. Since we believe that short-term market and economic prognostication is largely a fool's errand, we invest according to a strategy that makes the need to rely on short-term market or economic assessments largely irrelevant.

Our strategy is to seek to identify businesses and occasionally collections of assets which trade in the public markets for which we can predict with a high degree of confidence their future cash flows – not precisely, but within a reasonable band of outcomes. We seek to identify companies which offer a high degree of predictability in their businesses and are relatively immune to extrinsic factors like fluctuations in commodity prices, interest rates, and the economic cycle. Often, we are not capable of predicting a business' earnings power over an extended period of time. These investments typically end up in the "Don't Know" pile.

Because we cannot predict the economic cycles with precision, we look for businesses which are capitalized to withstand difficult economic times or even the normal ups and downs of any business. If we can find such a business and it trades at a deep discount to our estimate of fair value, we have found a potential investment for the portfolio. Next we look for the factors that have led to the business' undervaluation, and judge – based on our assessment of the company's governance structure, management team, ownership, and other factors – whether we can effectuate change in order to unlock value. When the price is right, the business is high quality, the management is excellent, and there are no changes to be made, we are willing to make a passive investment.

Our assessment of the short-term supply and demand for securities plays almost no role in our determining whether to invest capital, long or short. If we believed that it was possible to accurately predict short-term market or individual stock price movements and we had the capability to do so ourselves, we might have a different approach.

Over the past [11] years, we have profited not because of our predictive powers concerning macro events, but rather because of our ability to identify high quality companies with low business volatility that trade at a discount to intrinsic value, where catalysts exist or can be created to narrow the valuation gap.

Because we do not believe that we have a competitive advantage in predicting short-term market or economic conditions, we generally choose to invest in businesses that will excel in almost any economic environment. Even so, given that our funds have investments which are generally more long than short; an improving economy will assist the funds' performance.

We expect, however, that investment selection, rather than macro factors or stock market movements, will continue to be the principal determinant of our performance as the substantial majority of our historic (and anticipated) profits have come from the narrowing of valuation discrepancies between the prices we have paid for our investments (or received in shorting a security) and fair value.

Our Strategy's Structural and Competitive Advantages

As a large capitalization activist investor, we believe our strategy benefits from a large opportunity set, sizeable barriers to entry, and limited competition.

We believe that the largest companies offer the most opportunity for corporate change because they are typically held by passive shareholders and are too large to be vulnerable to private equity buyouts. Large cap businesses are typically high quality companies, as they would not typically achieve high valuations without substantial revenues, profits, and free cash flow. After decades of high profits and cash flows, many large businesses become less disciplined about cost control and capital allocation, and may otherwise lose focus. The number of large cap companies is substantial, particularly when compared to a strategy which, due to its concentration and long-term holding periods, requires that we identify only one or two new ideas per year to generate attractive returns for our investors.

Large capitalization shareholder activism has the benefit of significant barriers to entry to prevent large capital flows into the strategy. If one wishes to be a large cap activist, one has to raise large amounts of capital, which is difficult for a start-up investment manager to achieve. More significantly, the greatest barrier to entry for the strategy is the requirement that one build reputational equity among the community of investors who represent the largest shareholders of corporate America. It takes years to build a track record with institutions such that they are willing to back an activist seeking control or substantial influence over a corporation. It takes years of doing what we say we are going to do and strong investment performance to get the institutional and retail backing required to effect change at large cap companies. Our large and growing reputational equity will therefore remain a very significant moat for Pershing Square in the future. One of our additional barriers to entry is less tangible, but no less significant. It is best deemed creativity. Many of our most successful investments have been in situations and used transaction structures that were previously unprecedented.

Doing large unprecedented transactions attracts attention, some number of detractors, and enormous media and other public scrutiny. As we have said before, it requires a very thick and calloused skin. It also requires some tolerance from our investors who are likely to read periodic criticisms from those who resent our success and would like to see us fail, from our adversaries, and from members of the media who are often not that well informed of the facts, or otherwise fail to check so-called "facts" presented by our adversaries. We tolerate the enormous volumes of press and the occasional attacks as a necessary and unfortunate evil of a high-profile activist strategy.

Trading and Liquidity

Trading is largely an art and not a science, a discipline in which you can always look back and conclude that you could have done it better. That is one of the reasons why portfolio managers hire traders (it enables the portfolio manager to shift the blame to others) and why being a trader is such a treacherous job.

We seek investments in which there is a wide spread between price and value and then complete sufficient due diligence to obtain high conviction in our analysis. As a result, when we find something we would like to buy, once we have completed our work, our general approach is to buy as much of a particular security as we can without disturbing the price until we reach our targeted position size. In some cases, securities decline as we buy them (the ideal situation), in others they stay at approximately the same price, or alternatively they rise in price (the problematic case).

One of the reasons why we prefer liquid securities to illiquid situations is because of the greater probability that we will be able to acquire a position at or around the price that our analysis was based upon. Unless we believe that at the time of purchase, it is a once-in-a-lifetime buying opportunity (think GGP), we typically leave some room to increase our position if the price/value relationship becomes even more favorable in the future. Unlike many investors, we do not take token positions as we begin work and then add to positions as we build conviction. We are either all-in (while often retaining a “re-buy” ticket in our pocket), or we keep our chips in a large pile of U.S. Treasurys.

Scale and Shareholder Activism

We believe that large scale shareholder activism is one of the few investment strategies where there are economies and competitive advantages that come with scale. The economies of scale arise from the fact that large capitalization companies have typically never been pushed by an activist or a private equity investor and, as such, often offer unrecognized opportunities for value creation. These opportunities arise due to hidden value in undervalued subsidiaries or divisions, inefficient uses of capital, and opportunities for cost reduction and margin expansion. As our funds have grown in size, we are able to invest in and influence a universe of companies that previously were too large for us to work with. Historically, we have addressed this problem by raising SPVs to pursue a particular investment, although there are disclosure and other risks associated with using SPVs to address this issue.

From a competitive standpoint, we have few competitors in large cap shareholder activism, and we believe that we are unlikely to have many such new competitors in the future. This is due to the difficulty of raising sufficient capital to form a start up to pursue this strategy, and the time required to build the reputational equity needed to effectuate it. Large cap activism is one of the few investment strategies where one’s track record on previous investments increases the probability of success on future such investments. It takes years to build such a record, and as such, our track record of successful activism is an important long-term competitive advantage for Pershing Square.

While there are certain situations today that we will pass on because of their small size, there are others that we can now pursue that we would not have had the resources to execute in the past. In other words, while some smaller names have dropped off the list, new larger names have been added to our investment universe.

We believe that these larger businesses generally offer greater opportunities for the kinds of corporate change that we often pursue. This is due to the fact that these large enterprises have not been owned by active investors historically and have been largely insulated from private equity and other unsolicited investors because of their scale. As a result, we continue to believe that for the foreseeable future, scale will be an asset for Pershing Square, and, therefore, we have kept the [core private] funds open to new subscriptions. The goal has not been to raise additional capital, but rather to maintain capital stability by accepting capital to replace redeeming investors over time.

That said, we intend to manage our capital flows carefully. If we receive commitments for amounts that we feel we cannot invest or which will cause unacceptable dilution in current holdings, we will postpone accepting these funds until our circumstances change. While this may cause some investor nuisance, we will do our best to keep you in the loop so that we minimize any inconvenience on your part.

The alternative would be to close the funds temporarily or permanently. In light of the open-ended structure of [some of] our funds, we think that such an approach would lead to reduced stability in our capital base.

Transparency

Our goal in our communications with you is to give you the information we would want if our positions were reversed, that is, if we were the investor and you the investment manager. Using this paradigm, we endeavor to inform you about business challenges and related developments as promptly as practicable, as good news generally takes care of itself. We will, however, not disclose information to anyone (unless of course we are required to do so by law) if we believe it may compromise our investment program. Fortunately, our investment strategy by its nature is readily transparent because it is largely comprised of a small number of long investments in listed North American companies, and the amount of turnover in the portfolio is generally modest.

Transparency, however, creates risk for the funds because an early disclosure of a position that we are accumulating or selling would likely harm our ability to maximize value for our investors. For this reason, absent a legal requirement, we are careful to avoid making early disclosures of investment information that could be damaging to the funds.

Investor Relations

With more than [500 (and likely thousands more with PSH)] investors, the demand on my and other members of the Investment Team's time to meet with investors on an ad hoc basis risks taking time away from investment decision making and analysis. At the same time, investors have a right to a high degree of transparency in their investments in the funds.

As always, the Investor Relations team under Tony Asnes's oversight will be available to answer investor questions as they arise on a day-to-day basis. You should expect the IR team to be extremely well informed, and members of the team should be able to answer substantially all of the questions that you have, other than questions that if answered might disadvantage the firm.

I thoroughly enjoy the company of our investors. That is part of the problem. Time management for our small Investment Team is a critical success factor for Pershing Square going forward. We are confident that [our quarterly investor] calls will increase the quality and timeliness of information flow, decrease the time that I and the other members of the Investment Team spend in one-on-one meetings, while allowing the Investment Team to continue our pursuit of our most important long-term goal of delivering high returns while taking a modest risk of a permanent loss of fund capital.

Media

The nature of our investment approach has historically attracted large amounts of media attention which we have used to our advantage in negotiating with companies that are resistant to our ideas. Oftentimes, a public airing of issues is extremely effective in motivating a publicity-shy company to see the light on important shareholder and governance issues.

We have also cooperated with the media occasionally to do our part on behalf of the hedge fund industry in attempting to remove some of the stigma surrounding what hedge funds actually do and who hedge fund managers actually are, and to help mitigate some of the negative attention that our industry, undeservedly for the most part, receives.

We are going to make mistakes. Because we manage a large pool of capital and we make active investments in large capitalization, high-profile companies, our mistakes are often going to be much more visible than those of other investment professionals. The dollar losses are also generally going to be larger. Our mistakes are therefore going to attract a disproportionate amount of media attention. This media attention is a natural outcome of our high profile strategy. Over time, the media has been helpful in our engagements with our portfolio companies, and we expect the firm's visibility to continue to be a sustainable competitive advantage.

Confidence and Humility in Investing

Confidence and conviction without humility can be dangerous in the investment business. When one shares an investment thesis publicly, it can be more difficult to change one's mind because the human mind has a tendency to ignore data that are inconsistent with a firmly held view, and particularly so, when that view is aired publicly. That is likely why Wall Street analysts continued to rate MBIA a buy until it nearly went bankrupt. And, I believe it is why analysts will likely keep their buy ratings until Herbalife is shut down by regulators or the company faces substantial distributor defections [and collapses due to deteriorating fundamentals].

I have learned that the key to long-term success in investing is to balance confidence with the humility to recognize when the facts are no longer consistent with one's original investment thesis. It is critically important not to let psychological factors interfere with economic rationality in investment decision making.

Our willingness to change our mind and exit at a substantial loss on a high-profile investment [i.e., J.C. Penney] should give you comfort that we will make rational investment decisions without regard to emotional, personal or other considerations. This approach will likely serve to mitigate losses in failed investments and is a critical component of our long-term approach.

FOOTNOTES TO 2014 KEY HIGHLIGHTS AND INVESTMENT MANAGER'S REPORT

1 Performance results are presented on a gross and net basis. Net returns include the reinvestment of all dividends, interest, and capital gains and assume an investor has been invested in the relevant Pershing Square fund since inception and participated in any "new issues", as such term is defined under Rules 5130 and 5131 of FINRA. Net returns also reflect the deduction of, among other things, management fees, brokerage commissions, administrative expenses and historical or assumed performance fee/allocation (if any).

2 The inception date for the Company is December 31, 2012. The Company's performance fee during 2013 and 2014 was 16%. The 16% performance fee will be reduced by 20% of all performance fees/allocations earned by Pershing Square and its affiliates from other existing and certain future private funds, provided that no reduction will occur until certain expenses of the Company that have been advanced by Pershing Square (i.e., underwriting fees and other costs of the placing and admission of Public Shares, commissions paid to placement agents and other formation/offering expenses incurred during the private phase of the Company) plus a yield of 4.25 per cent. per annum (the "Offset Amount"), are recouped by Pershing Square.

3 The S&P 500 ("index") has been selected for purposes of comparing the performance of an investment in the Pershing Square funds with a well-known, broad-based equity benchmark. The statistical data regarding the index has been obtained from Bloomberg and the returns are calculated assuming all dividends are reinvested. The index is not subject to any of the fees or expenses to which a Pershing Square fund is subject. The Pershing Square funds are not restricted to investing in those securities which comprise this index, their performance may or may not correlate to this index and it should not be considered a proxy for this index. The volatility of an index may materially differ from the volatility of the Pershing Square funds' portfolio. The S&P 500 is comprised of a representative sample of 500 U.S. large cap companies. The index is an unmanaged, float-weighted index with each stock's weight in the index in proportion to its float, as determined by Standard & Poor's. The S&P 500 index is proprietary to and is calculated, distributed and marketed by S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC), its affiliates and/or its licensors and has been licensed for use. S&P® and S&P 500®, among other famous marks, are registered trademarks of Standard & Poor's Financial Services LLC. © 2014 S&P Dow Jones Indices LLC, its affiliates and/or its licensors. All rights reserved.

4 This report reflects the attributions to performance of the portfolio of the Company. Positions with performance attributions of at least 50 basis points are listed above separately, while positions with performance attributions of 50 basis points or less are aggregated.

The attributions presented herein are based on gross returns which do not reflect deduction of certain fees or expenses charged to the Company, including, without limitation, management fees and accrued performance fee. Inclusion of such fees and expenses would produce lower returns than presented here.

In addition, at times, Pershing Square may engage in hedging transactions to seek to reduce risk in the portfolio, including investment specific hedges that do not relate to the underlying securities of an issuer in which the Company is invested. The gross returns reflected herein (i) include only returns on the investment in the underlying issuer and the hedge positions that directly relate to the securities that reference the underlying issuer (e.g., if the Company was long Issuer A stock and also purchased puts on Issuer A stock, the gross return reflects the profit/loss on the stock and the profit/loss on the put); (ii) do not reflect the cost/benefit of hedges that do not relate to the securities that reference the underlying issuer (e.g., if the Company was long Issuer A stock and short Issuer B stock, the profit/loss on the Issuer B stock is not included in the gross returns attributable to the investment in Issuer A); and (iii) do not reflect the cost/benefit of portfolio hedges. Performance with respect to currency hedging related to a specific issuer is included in the overall performance attribution of such issuer.

The performance attributions to the gross returns provided herein are for illustrative purposes only. The securities on this list may not have been held by the Company for the entire calendar year. All investments involve risk including the loss of principal. It should not be assumed that investments made in the future will be profitable or will equal the performance of the securities on this list. It should not be assumed that investments made in the future will be profitable. Past performance is not indicative of future results. Please refer to the net performance figures presented on page 5.

5 PSLP's performance results are presented as it is the Pershing Square fund with the longest track record and substantially the same investment strategy to the Company. The inception date for PSLP is January 1, 2004. In 2004, PSLP earned a $1.5 million (approximately 3.9%) annual management fee and performance allocation equal to 20% above a 6% hurdle from PSLP, in accordance with the terms of the limited partnership agreement of PSLP then in effect. That limited partnership agreement was later amended to provide for a 1.5% annual management fee and 20% performance allocation effective January 1, 2005. The net returns for PSLP set out herein reflect the different fee arrangements in 2004, and subsequently. In addition, pursuant to a separate agreement, in 2004 the sole unaffiliated limited partner paid Pershing Square an additional $840,000 for overhead expenses in connection with services provided unrelated to PSLP, which have not been taken into account in determining PSLP's net returns. To the extent that such overhead expenses had been included as fund expenses, net returns would have been lower.

6 The performance fee of the Company would be 10% based on current levels of Company fee paying AUM and total Pershing Square private funds' fee-paying AUM as of February 28, 2015, assuming the Offset Amount (as defined below) is paid in full. References to "Company fee paying AUM" exclude any AUM attributable to management shares and references to "Pershing Square private funds' fee-paying AUM" exclude (i) any AUM attributable to investments in any Pershing Square fund by PSCM, its employees and affiliates and (ii) any AUM attributable to investments in PS V, L.P., PS V International, Ltd. and their affiliates.

The hypothetical cumulative net returns presented herein are calculated based on the application of the historical monthly net returns of PSLP as adjusted to reflect the hypothetical lower performance fee of 10%. This information is presented only for the limited purpose of providing a sample illustration. Furthermore, the information provided herein assumes that each of the relevant Pershing Square funds earns the same rate of return, net of management fee and expenses, but before performance fee/allocation, as PSLP. Actual performance of the other Pershing Square funds has differed in the past and is expected to differ in the future. As a result, actual returns may vary significantly from the hypothetical calculation set forth in this table.

7 While the Pershing Square funds are concentrated and often take an active role with respect to certain investments, they will own, and in the past have owned, a larger number of investments, including passive investments and hedging-related positions. "Short equity" includes options and other instruments that provide short economic exposure. All trademarks are the property of their respective owners.

It should not be assumed that any of the securities transactions or holdings discussed herein were or will prove to be profitable, or that the investment recommendations or decisions Pershing Square make in the future will be profitable or will equal the investment performance of the securities discussed herein. Specific companies shown in this presentation are meant to demonstrate Pershing Square's active investment style and the types of industries in which the Pershing Square funds invest and are not selected based on past performance.

8 Please see page 11 for a complete list of companies with respect to which Pershing Square has taken a public active role in seeking to effectuate change.