

## Investment Manager's Report

Dear Pershing Square Holdings, Ltd. Shareholder,

Below we provide PSH's performance since its inception. The period of the last twelve months has been the worst period of performance by a wide margin since the inception of the strategy on January 1, 2004. Performance has improved substantially in the last few weeks with significant progress at Valeant and increases in the value of other holdings bringing year-to-date performance through August 23, 2016 to -15.5%.

Pershing Square Holdings, Ltd. Performance vs. the S&P 500		
	PSH Net Return <sup>(1)</sup>	S&P 500 <sup>(3)</sup>
2013	9.6%	32.4%
2014	40.4%	13.7%
2015	(20.5)%	1.4%
YTD through June 30, 2016	(21.1)%	3.8%
Q3 through August 23, 2016	7.0%	4.5%
YTD through August 23, 2016	(15.5)%	8.5%
<b>January 2013 – August 23, 2016 <sup>(2)</sup></b>		
Cumulative (Since Inception)	3.3%	65.5%
Compound Annual Return	0.9%	14.7%

Past performance is not a guarantee of future results. All investments involve risk, including the loss of principal. Please see accompanying footnotes on page 14.

We recognize that the last twelve months have been extremely challenging for PSH investors. As the largest individual investors in PSH and in the private funds that are managed side by side with PSH, we have also borne substantial losses. We are working diligently to maximize the value of our existing holdings and to identify new opportunities for profitable investment. I am encouraged by our recent progress and look forward to updating you with additional developments as they occur.

In the following Portfolio Update section, we discuss each of our portfolio investments in detail. You will note that our portfolio companies are demonstrating strong and/or improving performance which has contributed to their recent stock price appreciation. In light of recent stock price appreciation and the existence of other potential investment opportunities, we have elected to sell a substantial portion of our investment in Zoetis and all of our investment in Canadian Pacific which, when combined with a portfolio sizing adjustment to Mondelez, has freed up a substantial amount of capital for new investments. As a result, the majority of the investment team's time is currently being spent actively researching potential new commitments.

The progress noted in the Portfolio Update below has begun to be reflected in performance. From the bottom (March 15, 2016) when PSH was down 26.4% year to date, NAV per share has risen from \$15.42 to \$17.70 (August 23, 2016), a 14.8% increase bringing year-to-date performance to -15.5%. PSH's stock price has underperformed the increase in NAV as the discount to NAV (currently 14.9%) has expanded slightly over that time period. We are cognizant of the substantial discount to NAV at which PSH trades, which we believe has been driven by a loss of confidence by some PSH investors as a result of events at Valeant. We expect that our recent progress at Valeant, further increases in NAV, coupled with the identification of one or more new investments will contribute to the closing of the discount.

**PERFORMANCE ATTRIBUTION<sup>(4)</sup>**

Below are the attributions to gross performance of the portfolio of the Company through June 30, 2016.

Winners		Losers	
Air Products & Chemicals, Inc.	1.2%	Valeant Pharmaceuticals International, Inc.	(17.8)%
Restaurant Brands International Inc.	1.1%	Platform Specialty Products Corporation	(1.3)%
All Other Positions	1.0%	Currency Derivatives	(1.3)%
		Herbalife Ltd.	(1.2)%
		Nomad Foods Limited	(1.0)%
		All Other Positions	(1.1)%
<b>Total Winners</b>	<b>3.3%</b>	<b>Total Losers</b>	<b>(23.7)%</b>
		<b>Total Winners and Losers YTD through June 30, 2016</b>	<b>(20.4)%</b>

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**PORTFOLIO UPDATE****Air Products and Chemicals, Inc. (APD)**

Air Products' recent quarterly results marked the eighth straight quarter of double-digit EPS growth as APD continues its impressive transformation under CEO Seifi Ghasemi and his team.

APD's fiscal year third quarter earnings per share of \$1.92 were up 16% while currency-adjusted EPS growth was 19%. These impressive results were driven by currency-adjusted sales growth of 4% and operating margins which were up 340 basis points (bps) to 23.0%. Sales growth was driven by 4% volume growth, largely due to volume contributions from growth investments, and flat pricing. Margins increased across each major operating segment, including each region for industrial gases as well as the non-core Versum materials technology business. We believe this broad-based operating improvement is a testament to the cultural impact Seifi has had on APD along with the benefits of the company's decentralized operating model which has empowered local operating executives to drive performance and unlock the company's latent potential.

On the strength of these strong results and its near-term outlook, APD increased the lower end of its fiscal year earnings guidance by \$0.05 to \$7.45 to \$7.55, which at the midpoint reflects 14% growth over the prior year despite modest foreign exchange headwinds.

While APD has made significant progress improving its operating margin from ~15.5% to ~23% since our investment, and now has a consolidated operating margin in-line with best-in-class peer Praxair, we believe that APD has additional opportunities to extract operating efficiencies. Adjusted for non-core businesses, APD's industrial gas margins remain substantially below Praxair's. Management has provided guidance which suggests that APD can extract \$225 million of additional operating efficiencies over the next three years.

The company remains enthusiastic about the growth capex opportunities for large on-site air separation units and hydrogen facilities, businesses in which APD has strong leadership positions. Seifi and his team are disciplined about investing capital in growth capex projects that meet appropriate return hurdles.

Air Products' plan to sell and spin off its non-core materials technology and electronics materials businesses is also progressing as planned. Subsequent to its announced spin off of these businesses as a newly formed company named Versum, the company announced the sale of the materials technology segment of the business to Evonik for 16 times EBITDA, a price that will yield an attractive ~12 times EBITDA net price for Air Products' shareholders after the company pays taxes on the gain from the sale of this business. APD is proceeding with the planned spinoff of the remaining electronics materials business in the coming months. The electronics business, which produced FY 2015 sales and EBITDA of \$1 billion and \$302 million, respectively, is a leading provider of materials and delivery

systems equipment to the semiconductor industry and has strong secular growth prospects due to the proliferation of consumer electronics devices around the world. The electronics business has meaningfully improved its operating margins and competitive positioning under CEO Guillermo Novo and his team, and is well positioned to be a successful independent company.

Overall, we expect APD to continue to deliver double-digit EPS growth for the next several years as it extracts additional cost efficiencies, brings on-stream growth capex projects, drives organic performance, and allocates capital to acquisitions, growth capex or the repurchases of its shares in a manner which maximizes returns for investors. We believe the company's long-term outlook remains robust and its shares remain at a discount to their intrinsic value.

### **Fannie Mae (FNMA) / Freddie Mac (FMCC)**

Fannie and Freddie's underlying earnings progressed modestly in the second quarter as their core mortgage guarantee businesses improved due to an increase in the guarantee-fee rate and lower credit costs. Their non-core investment portfolios continued to be reduced, which is leading them to a safer and more capital-light business model. As in recent quarters, reported earnings remained volatile due to non-cash-accounting-based derivative losses in the non-core investment portfolio. As a result of the derivative losses and the continued Net Worth Sweep, the companies remain at risk of being required to draw capital from the Treasury, as a result of the requirement to pay dividends to Treasury under the Net Worth Sweep of more than \$125 billion in excess of the original 10% dividend agreement. As the risk of capital draws from the Treasury increases, we believe that Congress will become increasingly focused on seeking a permanent resolution for Fannie and Freddie.

In the litigation, the government recently released additional documents which further support shareholder claims. From the documents, it is clear that high-level government officials were aware that the GSEs were expecting to become highly profitable just prior to the implementation of the Net Worth Sweep, which runs contrary to the government's contemporaneous public statements that the GSEs were in a "death spiral." In fact, private emails of key government officials show that the government intended to implement the Net Worth Sweep as a measure to prevent the GSEs from recapitalizing themselves and exiting conservatorship. Both of these points directly contradict key claims the government made on and after implementing the Net Worth Sweep and as a defense to the litigation. In addition, the courts rejected the government's request to have individual lawsuits consolidated as a multi-district litigation and sent to Judge Lamberth. This allows each case to continue to proceed separately and be evaluated on its individual merits, which improves the likelihood of a favorable legal outcome for shareholders.

We believe a new administration, which did not implement the Net Worth Sweep, will be more conducive to implementing a sensible resolution for Fannie and Freddie which benefits all stakeholders including tax payers, home owners and shareholders.

### **Herbalife Ltd. (HLF) Short**

We have made substantial progress with our short position in Herbalife. On July 15, 2016, after a more than two-year investigation, the FTC found that Herbalife has been operating illegally, misleading consumers about the potential profitability of its so-called business opportunity, among other extremely critical findings. The FTC's settlement with Herbalife avoided using the words "pyramid scheme" to describe its business, but found that the company had all of the hallmarks of other pyramid schemes it has prosecuted recently. The FTC's findings confirm each of our principal allegations against the company.

The FTC stated that it chose to settle with Herbalife to avoid an extended period of litigation and to bring relief to consumers more rapidly. While Herbalife has to-date successfully spun the terms of the settlement as a victory for the company, the facts speak differently as the market appears to have recently begun to understand. While Herbalife stock rose more than 20% on the initial announcement of the settlement, it has declined since that time, and is now trading at approximately the same price as before the announcement.

Under the terms of the FTC settlement, the company is being required to totally restructure its business and compensate its distributors only for "profitable retail sales" to consumers who are not distributors pursuing the business opportunity (other than for a limited carve out for personal consumption of the product by distributors). In light of the fact that the FTC found little if any evidence of profitable retail sales, it is difficult to understand how the

company can continue to motivate and recruit distributors to replace the more than 2,000,000 who quit each year when these aspiring distributors realize they cannot make money. As a result, we expect Herbalife to collapse as distributors leave as a result of the newly restructured compensation arrangements and required changes in marketing practices. While it is difficult to estimate a precise time frame for the company's demise, we believe it will not be years. We have already described the Complaint and Settlement Agreement in detail during our July 20, 2016 conference call and presentation which is available on the PSH website, [www.pershingsquareholdings.com](http://www.pershingsquareholdings.com). In summary, the FTC findings make clear that Herbalife is a pyramid scheme.

A comparison of the FTC's findings about Herbalife with previous FTC pyramid scheme prosecutions reveals similar and often nearly identical language. The FTC Complaint alleged that Herbalife participants are "primarily compensated for successfully recruiting" new participants and not for selling products, the defining attribute of a pyramid scheme which has been alleged in each of the most recent FTC pyramid scheme cases. Exhibit I, which starts on page 32 of this report, compares the FTC's allegations against Herbalife and other companies the FTC deemed to be pyramid schemes. Most notably, the count against Herbalife for Unfair Practices closely mirrors the Illegal Pyramid counts in previous cases. It is clear from Exhibit I that the FTC found Herbalife to be an illegal pyramid scheme and alleged the necessary findings to support that charge but, as part of the settlement, agreed to avoid using the phrase "pyramid scheme." FTC Chairwoman Ramirez's public comments corroborate this conclusion.

We believe the implementation of the Settlement Agreement – the most comprehensive business model reform required by the FTC against any multi-level marketing company – will cause Herbalife's U.S. business to collapse and contribute to the eventual failure of the entire company. The settlement represents Herbalife's agreement to engage in a "top to bottom"<sup>i</sup> restructuring of its business model in the United States. Key elements include:

- Compensation to distributors is limited to verifiable, "Profitable Retail Sales"<sup>ii</sup>;
- Present compensation levels remain only if 80% or more of U.S. sales are verifiable, "Profitable Retail Sales";
- At least two-thirds of rewards paid by Herbalife to distributors must be based on Profitable Retail Sales of Herbalife products that are tracked and verified;
- Qualification purchases are prohibited;
- Misleading income claims are prohibited; and
- An Independent Compliance Auditor will be hired to oversee compensation plan changes for a period of seven years.

Since the day of the FTC settlement announcement, Herbalife has orchestrated a coordinated media campaign to misrepresent the findings of the FTC and the inevitable business impact of the relief demanded by the FTC.

On August 3, 2016, Herbalife reported its second quarter financial results. On the conference call, Herbalife management was consistently upbeat and bullish on the prospects for the business in the face of the FTC settlement, noting "these changes are good for our company," and "we have the greatest confidence in our ability to comply with the agreement and continue to grow our business in the U.S. and around the world." Management's latest commentary is a continuation of prior misrepresentations.

Herbalife's 10Q provided revised disclosure pertaining to the FTC settlement and updated risk disclosures. It struck a more balanced, and at times cautionary, tone compared with management commentary on the call, noting that "there is no guarantee that we will be able to fully comply with the Consent Order," and "[t]he impact of the Consent Order on our business ... could be significant." All the same, the 10Q reiterated that Herbalife "neither admitted nor denied the allegations in the FTC's complaint<sup>iii</sup> in agreeing to the terms of the Consent Order," and repeated the company line that "we do not believe the Consent Order changes our business model as a direct selling

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<sup>i</sup> <https://www.ftc.gov/news-events/blogs/business-blog/2016/07/its-no-longer-business-usual-herbalife-inside-look-200>

<sup>ii</sup> FTC v. Herbalife International of America, Inc., et al. (July 15, 2016). Stipulation to Entry of Order for Permanent Injunction and Monetary Judgment at p.5.

<sup>iii</sup> FTC v. Herbalife International of America, Inc., et al. (July 15, 2016). Case No.2:16-cv-05217, Complaint for Permanent Injunction and Other Equitable Relief.

company.” The 10Q included new language noting that the Consent Order does not prevent “other third-parties from bringing actions against us, whether in the form of other state, federal or foreign regulatory investigations or proceedings, or private litigation, any of which could lead to, among other things, monetary settlements, fines, penalties or injunctions.”

At a minimum, we believe the injunctive relief demanded by the FTC is likely to significantly weigh on Herbalife’s financial performance in the coming quarters. Moreover, we believe that the FTC complaint and settlement provide a roadmap for other state Attorneys General and regulators in 93 other countries around the world to seek similar relief and to enforce similar protections for their consumers.

Despite a bleak financial outlook, Herbalife is trading at ~13.5x the midpoint of management’s revised 2016 guidance (\$4.50 to \$4.80) or ~16 times 2016 guidance excluding certain items (which we believe are ongoing costs to the business but which Herbalife management inappropriately adds back). The implied multiple represents an even higher multiple of 2017 earnings, as Herbalife’s future earnings are likely to be significantly lower as changes to the business model reduce the company’s earnings power. These estimates exclude additional fines and/or the impact of additional injunctive relief that may arise from other regulatory agencies.

Herbalife stock price hit a recent high in the low \$70s per share on the day of the settlement, but has declined to less than \$62 currently. Putting aside the short case for Herbalife, it has become extremely difficult to comprehend the logic behind the bull case on Herbalife.

The bulls had believed that the FTC settlement would exonerate the company and otherwise not require any material changes to the company’s business practices. This is definitively false based on the FTC Settlement and Order.

Second, the bulls believed that the company would announce a large leveraged recap at the time of a settlement. When pressed about buybacks on the recent earnings call, the CFO demurred and reminded investors about the maturity of its credit facility in March 2017 and the \$1.15 billion out-of-the-money convertible debt issue which is due within three years. We do not believe that banks and/or bondholders are likely to be willing to provide a material amount of debt financing to Herbalife in light of the FTC findings, and without knowing the revenues, earnings, and cash flow implications of the FTC’s required business changes, which will not be fully implemented until May of next year.

Third, China, which has been the growth engine of the company in recent years, showed dramatically decelerated growth for the quarter calling into question its sustainability. Herbalife management stated that investors are likely to see “a significantly lower growth rate going forward” and that they do not believe China’s growth rate is “sustainable at the current levels.”<sup>iv</sup>

Fourth, long-only institutional investors appear to be exiting, with Fidelity, a long-time shareholder selling nearly 40% of its holdings as disclosed in its recently updated 13G filing. Fidelity will not be required to notify the market of additional sales until mid-November. Capital Research has also been a substantial seller. In light of the FTC’s findings of wrongdoing, we do not believe that legitimate institutional investors will continue to own Herbalife. The substantial majority of other holders appear to be fast-money investors who we believe mistakenly bought on the announced settlement, betting on a buyback, when more than 50% of the float on that day changed hands at prices nearly 20% above current levels.

Lastly, at current prices it is difficult to make a compelling argument for owning Herbalife even if one does not believe it is a pyramid scheme. The stock trades at about a 50 percent multiple premium to legitimate supplement retailers like GNC, which, unlike Herbalife, is not being required to completely change the way it compensates its distributors as well as its marketing practices.

While it has been a long road, we see multiple paths to an eventually successful outcome with this investment.

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<sup>iv</sup> Herbalife Q1’2016 Conference Call, John DeSimone

**The Howard Hughes Corporation (HHC)**

HHC's second quarter report highlighted the continued progress it is making across all of its initiatives and business segments.

Net operating income ("NOI") from HHC's operating assets increased from \$28.5 million to \$36.3 million year-over-year as recently developed properties continue to stabilize. HHC held steady its projected annual stabilized NOI estimate (excluding the South Street Seaport) of \$215 million after increasing it from \$203 million at year-end. Land sales closed in its Master Planned Communities ("MPC") segment decreased from \$47 million to \$34 million year-over-year in Q2 due to weakness at Woodlands in Houston and timing of superpad sales. The housing market in Summerlin remains strong as demonstrated by \$48 million in land sales at The Summit, which is HHC's luxury golf course joint venture development within Summerlin. The Woodlands, which develops and sells lots at the upper end of the Houston residential market continues to experience a slowdown in housing activity. HHC saw increased activity, land sale closings and absorption rates at Bridgeland due to stronger demand for more affordable lots in Houston.

At the Ward Village in Honolulu, construction of the Waiea and Anaha condo towers continues on plan. Over 85% of the total square feet available for sale is now under contract at both the Waiea and Anaha condos. The 174-unit Waiea condo is expected to be completed by year-end, at which point HHC will begin to generate a significant amount of cash flow from condo closings. Anaha, a 317-unit project, is expected to be completed by the second quarter of 2017. In February 2016, HHC began construction of Ae'o, the third of four mixed-use residential towers planned for the first phase of the Ward Village development. Whole Foods has pre-leased a substantial portion of the retail space at the base of this tower, which is scheduled for completion in late 2018. Pre-sales are ongoing at the 466-unit Ae'o tower with 45% of the total residential square feet available for sale under contract. The fourth condo tower, the 424-unit Ke Kilohana, sold 90% of its units in five days (in April 2016). Ke Kilohana is a workforce residential tower with 375 of its units designated for local residents. Total construction costs for all four towers are expected to be \$1.45 billion of which HHC has incurred \$523 million.

While HHC did not announce any new material developments at the South Street Seaport in Q2, we are optimistic about the potential for significant value creation at the Seaport.

**Mondelez International (MDLZ)**

On June 30, 2016, press reports, which were later confirmed, stated that Mondelez had made an offer to acquire The Hershey Company for \$107 per share in a half-cash, half-stock transaction. While an acquisition of Hershey would certainly strengthen Mondelez's confectionery presence in North America, whether or not a deal creates value for shareholders depends on the price paid, the acquisition currency used and, as importantly, the potential for significant cost savings at Hershey.

We believe that Mondelez shares are currently undervalued, and that the issuance of Mondelez stock at current prices to fund the acquisition of Hershey would likely be costly for Mondelez shareholders. More importantly, if Mondelez were to acquire Hershey or any other company, management must continue to be accountable for its own target of 17% to 18% operating profit margins by 2018 at the existing Mondelez business, excluding the impact or benefit of any acquisitions. We expect that shareholders would find it unacceptable for an acquisition of Hershey by Mondelez to delay or derail the productivity and cost savings transformation currently underway at the company.

On July 27, 2016, Mondelez reported second quarter 2016 results. Underlying organic growth was generally in-line with Mondelez's categories at 2.5%, including volume growth of nearly 1% which was a sequential acceleration of 60 basis points from the first quarter. While we believe that the long-term outlook for the global snacks categories in which Mondelez participates remains robust, the company is currently facing short-term headwinds from slowing emerging market economies.

Operating profit margins expanded by 265 basis points to 15% in the quarter driven primarily by a 200 basis point reduction in overhead costs as a percentage of sales reflecting the implementation of zero-based budgeting as well as an increase in gross margin reflecting the company's supply chain transformation. Year-to-date, the company continues to show progress with its significant cost savings opportunity and productivity initiatives.

**Nomad Foods (NOMD)**

Nomad, the packaged frozen food company, announced second quarter results on August 25, 2016. Revenue for the quarter declined 3.8% on a like-for-like basis, excluding foreign currency changes. This marked the third straight quarter of sequential improvement in revenue trends. Margins and cash flow remained strong. The company reiterated its guidance for continued sequential revenue improvement throughout the year and €200 million of cash flow.

Nomad stock trades at ~9 times management's cash flow guidance per share, less than half the price of other packaged food businesses. We believe the company is taking the right actions to stabilize and enhance the business while integrating its recent Findus acquisition and working to deliver anticipated synergies.

**Platform Specialty Products Corporation (PAH)**

Platform's earnings declined in the second quarter as positive results in Performance Solutions, increased cost synergies, and strong growth in the International Ag Solutions were offset by a significant decline in the North American Ag Solutions business and increased corporate costs.

Platform's organic revenue increased 1% as Ag Solutions grew 5% and Performance Solutions revenue declined 2%. Ag Solutions achieved double-digit growth outside of North America (more than 80% of segment revenue), which was offset by a more than 40% decline in North America. The decline in North America resulted from the continued reduction in distributor channel inventories, decreased demand for pesticides due to lower pest pressures, and lower market share. The company stated that it has made changes to its sales force and product development initiatives and expects these efforts to improve business results over time. Performance Solutions' organic revenue declined primarily due to weakness in the electronics market in Asia, which the company noted should return to growth in the second half of the year.

Platform's organic EBITDA was down nearly 6%, as the growth in Performance Solutions and cost synergies were more than offset by the decline in Ag Solutions and higher corporate costs. In Performance Solutions, organic EBITDA increased 4%, as an improved sales mix of higher-margin products and cost synergies more than offset an increase in corporate expenses. In Ag Solutions, organic EBITDA declined 15%, as the higher sales mix of lower-margin products and the declines in the relatively higher-margin North American business more than offset increased cost synergies. Reported EBITDA declined 10% due to the negative headwinds from FX. As a result, EPS declined 36% due to the negative impact of financial leverage.

While Platform delivered mixed performance for the quarter, we are starting to see business progress under Platform's new CEO Rakesh Sachdev. We think highly of Rakesh and believe he possesses the necessary leadership qualities and experience to improve the performance of Platform.

**Restaurant Brands International Inc. (QSR)**

Restaurant Brands reported another strong quarter of underlying earnings in the second quarter of 2016. The company continued to deliver strong net unit growth at both concepts while substantially improving Tim Hortons' cost structure. Same-store-sales growth decelerated from prior quarters against a backdrop of slowing growth for the U.S. fast-food industry.

Same-store-sales for the quarter grew nearly 1% at Burger King and 3% at Tim Hortons. Same-store-sales for Burger King's U.S. business declined 1% in the second quarter, due in part to the industry slowdown and a tough comparison against nearly 8% growth in last year's second quarter. Over time, we expect Burger King's U.S. same-store sales to increase at a healthy rate as the company narrows the sales gap with its key U.S. competitors. Net units grew 4% and the development pipeline remains strong. As a result of same-store-sales and net unit growth, Restaurant Brands' organic revenue grew 4%.

The company continued to reduce Tim Hortons' overhead costs and improve margins in its franchised operations and distribution businesses. As a result of strong top-line trends and cost reduction initiatives, Restaurant Brands grew organic EBITDA 16% this quarter. Although the strengthening USD remained a headwind, Restaurant Brands' reported EBITDA grew 12%.

**Valeant Pharmaceuticals International (VRX)**

At the time of our last financial report in March, Steve Fraidin and I had just joined the board of Valeant in an attempt to stabilize and enhance our investment in the company. Since we joined the board, the company has hired Joe Papa, an extremely capable and talented CEO, the substantial majority of the board has been replaced, the company has returned to filing its financial reports in a timely fashion, its bank debt has been successfully modified to substantially reduce the risk of covenant default, a highly credible and experienced CFO, Paul Herendeen, and General Counsel, Christina Ackermann, have joined the company, a new strategy and new financial reporting structure have been announced, and approximately \$8 billion of assets are being evaluated for potential disposition.

As a result of the above developments, we believe that Valeant has been successfully stabilized and is on the path to recovery. While we still expect the occasional negative press article about the company due to the ongoing government investigations and civil litigation, continued business progress should begin to focus investors and the public's attention on the company's high quality brands and products and its mission to improve patients' lives. With improved business performance, cash generation and leverage reduction, we expect Valeant's stock price to increase substantially from current levels.

Valeant reported Adjusted EBITDA of \$1.09 billion in the quarter and Adjusted EPS of \$1.40. This represented sequential improvement vs. Q1 as the business continues to stabilize following the disruption from the events of the fall / winter of 2015.

Management reaffirmed full year 2016 guidance of \$4.80 to \$4.95 billion of Adjusted EBITDA and Adjusted EPS of \$6.60 to \$7.00. On the earnings call, management discussed some of the key factors which are likely to accelerate growth through the end of the year including: increased profitability in dermatology, an acceleration in script growth at Salix (principally Xifaxan), emerging markets growth, the launch of Relistor Oral and traditional seasonality in the business.

Management announced specific actions the company has taken in recent weeks to return the dermatology business to profitable growth, including progress in improving the Walgreens distribution arrangement (beginning August 5, 2016), the launch of a coupon program for independent pharmacies (June 27th), a new prior authorization program administered by CoverMyMeds (August 4, 2016) and enhanced pharmacist training and education. Each of these initiatives should help improve the profitability of the dermatology franchise which has been challenged in recent quarters. On the earnings call, management discussed a plan to reduce the cost structure in-line with the current revenue base driven by consolidation of duplicative functions, vendor rationalization and other efficiencies.

The company introduced a new financial reporting structure which will be rolled out later this year. The business will now be aligned across three verticals: (1) Bausch + Lomb / International ("Durable Growth"), (2) Branded Rx ("Growth") and (3) U.S. Diversified Products ("Cash Generating"). This new disclosure provides a more logical and informative description of Valeant's different businesses, which when coupled with greater disclosure, provides investors with a more complete understanding of Valeant's growth trajectory, business durability and quality. Because Valeant's higher quality growth businesses – which represent 80% of revenue – are expected to grow rapidly, while the company's lower quality businesses – which currently represent 20% of revenues – are declining, over time Valeant's overall growth rate and business quality and cash flow durability should improve. This should lead investors to pay a higher valuation for the company over time.

In conjunction with the new reorganization, Valeant announced promotions of current executives and the hiring of three new executives: Christina Ackermann (EVP, General Counsel), Scott Hirsch (SVP, Business Strategy and Communications) and Sam Eldessouky (SVP, Corporate Controller and Chief Accounting Officer). On August 22, 2016, Valeant announced that Paul Herendeen, previously the CFO of Zoetis, would become CFO of the company. We think Paul is a superb choice in light of his long-term track record as a public company CFO in the specialty pharmaceutical industry, including his experience in turnarounds, highly leveraged situations, and his recent tenure at Zoetis where he led a substantial cost reduction initiative. We were very impressed with the work Paul did at Zoetis and are delighted to be working with him at Valeant.

Management reiterated its expectation to substantially reduce leverage in the coming months. The company expects to reduce debt by more than \$5 billion over the next 18 months funded primarily by cash flow and to a lesser extent by asset sales. Management announced that it had identified non-core assets which represent a transaction value of

~\$8 billion or 11 times EBITDA (based on comparable assets sales and/or unsolicited indications of interest) which are being evaluated for divestment. Valeant owns a large collection of highly marketable assets which, due to the highly acquisitive and well-capitalized nature of the pharma sector, should be able to achieve attractive transaction values in our view.

Lastly, management noted that while the company is projected to be in compliance with its financial maintenance covenants under the bank debt through 2016 at current guidance, the “cushion is not as large” as management would like it to be. As a result, the company has negotiated a favorable modification of its bank credit facilities to reduce EBITDA maintenance covenants and permit a greater amount of asset sales.

There is still a lot more work to do, but we are pleased with the company’s progress over the last several months.

### **Zoetis Inc. (ZTS)**

Zoetis delivered another exceptional quarter of performance. Organic revenue growth was +4%, driven by +13% growth in Zoetis’ companion animal segment. Excluding the revenue impact of the company’s operational efficiency initiatives, organic revenue growth was 9%. Management’s execution of its operational efficiency initiative continues to be excellent. SG&A as a percentage of sales fell by 180bps in the quarter, year-over-year and gross margins expanded 240bps. While we have sold a substantial portion of our investment to raise capital for new investments, we continue to believe that Zoetis’ history of strong organic growth and margin expansion will continue.

### **Foreign Currency**

In order to hedge currency exposure with respect to certain portfolio companies with non-U.S. revenues and earnings, we may enter into forward contracts or purchase currency options. For example, we have historically hedged substantial portions of Canadian Pacific’s and Restaurant Brands’ Canadian Dollar exposures.

### **Exited Positions**

#### **Canadian Pacific Railway Limited (CP)**

On August 4, 2016 we sold our remaining 9.8 million shares of Canadian Pacific. This sale marked the end of our five-year investment in CP, which was a noteworthy success. I have agreed to continue on the board up until the next annual meeting or until qualified replacement directors have joined the board.

We initiated our investment in Canadian Pacific in the fall of 2011. Prior to our investment, CP had meaningfully underperformed its closest competitor, Canadian National (“CN”), and the other North American railroads in nearly all key operating measures for more than a decade, a performance deficit best illustrated by CP’s operating margin of 19%, or about half of CN’s 37% margins at the time. As a result of this underperformance, CP’s shares had languished behind competitors and its potential for many years.

After performing due diligence on the Company for several months, we concluded that CP’s network and assets had no structural deficiencies relative to competitors, and that with proper leadership and an operational transformation we believed that CP could produce margins approaching industry-best levels, an achievement which would lead to substantial improvements in earnings and cash flow and drive significant long-term shareholder value. These views were in stark contrast to the incumbent management team’s and board’s assertions that CP was structurally limited, an opinion which was widely accepted by the investment community due to years of the company’s poor performance. During our research we learned about, and eventually developed a relationship with, Hunter Harrison, a legendary railroad executive who had twice before doubled the margins and transformed industry-lagging railroads. We were confident Hunter could repeat this feat for a third time if given the opportunity to fix CP.

We bought a 14% ownership stake in CP and subsequently engaged with CP’s Chairman, CEO, and board of directors to explain our views on the company’s underperformance and its potential for improvement under Hunter’s leadership. We stated our and Hunter’s view that under his leadership CP’s margins could conservatively improve to 35% over four years or by 2015.

Despite our well-researched views and plans to create long-term shareholder value by installing Hunter Harrison as CEO, CP’s legacy board resisted our suggestions and backed the status quo. We therefore had no choice but to run a

proxy contest to solicit the support of shareholders to decide the path forward for their company. We proposed to CP's shareholders the nomination of seven new directors, including two Pershing Square representatives. In May 2012, all seven of our director nominees were elected to the CP board, each with the support of at least 85% of CP's shareholders. The six CP directors who received the fewest votes, including CP's incumbent chairman and its CEO, resigned from the board, and the new board proceeded to launch a search for a new CEO. The board shortly thereafter unanimously chose to elect Hunter Harrison as CEO.

Hunter and his successor Keith Creel proceeded to make rapid improvements to the business. Operating margins improved at a faster pace and to better levels than we had communicated to investors with CP delivering a 39% margin in 2015 and an expected 41% margin in 2016 based on the company's guidance. As a result, the company's cash flow grew rapidly allowing CP to substantially increase its investment in the railroad, improving the network, which along with the railroad's newly implemented precision scheduled operating model allowed for a dramatic improvement in service to customers.

As a result of Hunter's, Keith's and the team's efforts, CP's earnings power has more than tripled since our investment and its share price has increased from the day-before our investment price of \$46 CAD (and our average cost of \$56 CAD) to \$197 CAD per share<sup>v</sup> currently. While activist investors are often accused of focusing on shareholder value at the expense of creditors – this has not been the case with Pershing Square – CP's bonds over the course of our involvement have been re-rated from barely BBB-/Baa3 to BBB+/Baa1 today, and its pension deficit, when we joined the board of more than \$1 billion, is now in surplus.

Today, CP has a strong board and management team, has become a best-in class-operator, serves its customers with better and more timely service, has a much better maintained and significantly enhanced network, and is thus built to thrive over the long term. During our tenure at CP, all stakeholders have benefited enormously. We are incredibly grateful to Hunter and entire management team and board at CP for achieving these remarkable results.

## ORGANIZATION UPDATE

Recent events have reminded us of the importance and potential impact of legal, regulatory, reputational, and political issues on our portfolio companies. While we have always considered these factors in analyzing and monitoring investments, we believe our investment process would be enhanced by having a member of the investment team who is entirely dedicated to focusing on these issues with respect to existing holdings and new investments. Jenna Dabbs recently joined the investment team to take on this role. Jenna has been a member of the legal team since January 2015. Previously Jenna spent eight years with the Department of Justice in the Southern District of New York as a Federal Prosecutor.

Jordan Rubin, a member of the investment team, will be departing shortly to pursue a startup venture outside the investment management industry. We wish Jordan great success in his new venture.

Thank you for your continued support. Please feel free to contact the Investor Relations team or me if you have questions about any of the above.

Sincerely,



William A. Ackman

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<sup>v</sup> The performance of Canadian Pacific share price is provided for illustrative purposes only and is not an indication of future returns of PSH.

**FOOTNOTES TO INVESTMENT MANAGER'S REPORT**

- 1 Net returns include the reinvestment of all dividends, interest, and capital gains and reflect the deduction of, among other things, brokerage commissions, administrative expenses, management fees and historical or accrued incentive fees (if any). Performance results provided herein also assume an investor has been invested in the Company since inception and participated in any "new issues" as such term is defined under Rules 5130 and 5131 of FINRA.
- 2 The inception date for the Company is December 31, 2012. The performance data presented on page 4 for the S&P 500 under "Cumulative (Since Inception)" is calculated from December 31, 2012.
- 3 The S&P 500 ("index") has been selected for purposes of comparing the performance of an investment in the Company 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 PSH is subject. PSH is not restricted to investing in those securities which comprise this index, its 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 PSH's 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. © 2016 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 incentive fee (if any). Inclusion of such fees and expenses would produce lower returns than presented here.

In addition, at times, PSCM 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. All other currency positions are aggregated.

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 4.

**Limitations of Performance Data**

Past performance is not necessarily indicative of future results. All investments involve risk including the loss of principal. This report does not constitute a recommendation, an offer to sell or a solicitation of an offer to purchase any security or investment product. This report contains information and analyses relating to all publicly disclosed positions above 50 basis points in the Company's portfolio during 2016. PSCM may currently or in the future buy, sell, cover or otherwise change the form of its investment in the companies discussed in this report for any reason. PSCM hereby disclaims any duty to provide any updates or changes to the information contained here including, without limitation, the manner or type of any PSCM investment.

**Forward-Looking Statements**

This report also contains forward-looking statements, which reflect PSCM's views. These forward-looking statements can be identified by reference to words such as "believe", "expect", "potential", "continue", "may", "will", "should", "seek", "approximately", "predict", "intend", "plan", "estimate", "anticipate" or other comparable words. These forward-looking statements are subject to various risks, uncertainties and assumptions. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. Should any assumptions underlying the forward-looking statements contained herein prove to be incorrect, the actual outcome or results may differ materially from outcomes or results projected in these statements. None of the Company, PSCM or any of their respective affiliates undertakes any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by applicable law or regulation.