Value Investor INSIGHT
The Leading Authority on Value Investing
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Beyond the S&P 500

Following the crowd has been a good place to be in the stock market for some time. On the chance that one day changes, we spoke with eight highly accomplished, crowd-avoiding investors about where they are finding opportunity today. Among areas of interest: energy, small caps, metals and mining, shorting, non-U.S. stocks and, of course, bargain prices.

Editor's Note: *Research Affliates has a nice feature on its website that provides expected 10-year nominal returns for a wide variety of asset classes. Like most such forecasts – including those from GMO, Goldman Sachs, J.P. Morgan and others – they heavily weight current valuations in assigning the expected future returns.*

It's unsurprising, then, that Research Affiliates' expected future returns for various equity classes differ substantially from the 10-year historical returns of those classes. U.S. large-cap growth stocks, the stars of global equity markets for years, are expected to return a paltry 2.1% annually over the next ten years. Large growth stocks in non-U.S. developed markets are pegged to earn 3.1% per year. The top three categories for expected return are all value-based: emerging markets value (10.5%), developed markets ex-U.S. large value (9.8%), and developed markets small value (9.7%).

In the spirit that the next ten years may not look like the last ten years for equity investors, we are devoting this entire issue of VII to conversations with highly accomplished investors who are going against the grain to find unrecognized value in areas highlighted by their lagging 10-year historical returns shown in the chart above.

While hesitant to call the timing of any shifts in market leadership, these investors explain where they're finding opportunity: in value, of course, but also in energy, small caps, non-U.S. markets, metals and mining, and shorting. As Bob Robotti of Robotti & Co. puts it, "We like to say the puck is at one end of the ice, but the opportunity is at the other end and there's nobody in front of the net."

INVESTOR INSIGHT

Robert Robotti
Robotti & Co.

"If higher inflation and interest rates lower the cap rates on all kinds of assets, that changes where the opportunity is."

You've seen some full market cycles. Where would you say we are in the current one?

Robert Robotti: The first thing I'd emphasize about seeing a number of cycles is that valuation matters. That gets minimized in markets like we've been in, but in the end that's what really determines the performance of stocks. I'm talking about valuation relative to the cash flows a business can produce. We're finding a lot of things compelling today on that basis.

What we don't find compelling are all these wonderful companies whose valuations seem to embed the idea that they'll be as wonderful going forward as they were during the long period post financial crisis when inflation was low, interest rates were low, and the capitalization of earnings was high. Changes in any of those things can upset the apple cart, as we saw briefly in 2022 before everyone decided to forget about it. We believe, for example, that inflation is the normal course of events in economic activity, and that there are an increasing number of inflationary pressures out there in the world today. If you see an environment where higher inflation and interest rates lower the cap rates on all kinds of assets, that dramatically changes where the investment opportunity is. What is for sure, there is no margin of safety in the market darlings.

We invest in cyclical, commodity businesses that many value investors have given up on because they've had bad experiences in the past. We think the opportunity there is quite good in today's market, with stocks on both a current and normalized basis trading at very modest absolute valuations in companies with attractive growth outlooks. We like to say the puck is at one end of the ice, but the opportunity is at the other end and there's nobody in front of the net.

How does offshore-drilling service provider Tidewater [TDW] fit the bill for what you find compelling today?

RR: The company is a leading global contractor of offshore support vessels (OSVs) that ferry people and equipment to and from offshore energy projects, from the early engineering phase, through installation, to development and drilling. It's a cyclical business with long cycles, therefore too uncertain for many investors, but we believe the supply/demand dynamics are working in Tidewater's favor and don't warrant a share value that is far below the replacement cost of the company's assets.

On the demand side, while there is still a buggy-whip concern hanging over oil and gas, in the last two years people have started to realize that to support a growing world, peak oil is likely quite a bit further off than once perceived. At the same time, offshore is increasingly a necessary and cost-effective way to meet ongoing demand for both oil and natural gas. Low-cost shale reserves deplete rapidly, while offshore fields deplete more slowly and can produce for 20 years or more. Most importantly, with technological and other improvements in offshore field design, pipeline capability and standardization, the breakeven cost to develop offshore fields has declined and is very competitive today. Almost 60% of offshore projects are breakeven at $40 oil.

The big multinationals are recognizing the need to invest offshore to meet demand needs. A company we follow closely is Subsea 7 [Oslo: SUBC], which does engineering design and installation for offshore fields. Its activity backlogs have never been higher and continue to grow. People look at current drilling statistics, which can be volatile, but we think Subsea 7's backlog of business gives us pretty good visibility into the ramp of offshore activity over at least the next three years.

On the supply side we see structural limits to expanding capacity. A lot of vessels taken out of service in the last 10 years are theoretically still in the current supply, but the reality is that many of them won't ever make it back into service. (If they were viable they would have been reactivated in recent years.) The latest-generation offshore drill rigs can cost $1 billion, which would require rental day rates far above current levels to make economic sense to build. And that's if you found anyone willing to spend $1 bil-lion on a long-term asset where the terminal value is legitimately uncertain.

The company in recent years has been buying up assets from competitors that are leaving the industry. Has that been the best use of capital?

RR: Having come out of bankruptcy several years ago with a clean balance sheet, Tidewater has been uniquely positioned to buy assets at distressed prices, consolidating market positions in areas of the world where it was already strong, and becoming more competitive in parts of the world where it wasn't as established. I'm on the board so I should say this, but as a shareholder I think at the prices they paid these acquisitions have enhanced per-share value. The company last year generated over $300 million in free cash flow and the balance sheet is modestly leveraged. If other assets came up for sale, Tidewater is positioned to be opportunistic. If not, that's fine too, and they can just continue to pay down debt and return more cash to shareholders.

From today's $43.50 share price, how are you looking at valuation?

RR: The current market cap is just over $2 billion, so on last's year's results the free-cash-flow yield is around 15%. The cost to replicate the fleet is $8 billion, so the stock trades for a quarter of replacement cost.

The free-cash-flow yield is already attractive, but we expect over the next few years for free cash to increase significantly. With rising utilization and day rates averaging, say, $30,000 per day – still below earlier cycle highs – I can see a path to the company generating closer to $1 billion in

INVESTMENT SNAPSHOT

Tidewater
(NYSE: TDW)

Business: Leading global owner and operator of a fleet of support vessels that ferry people, equipment and supplies to and from offshore oil, gas and wind-power facilities.

Share Information (@3/28/25):

Price	**43.46**
52-Week Range	38.65 – 111.42
Dividend Yield	0.0%
Market Cap	$2.24 billion

Financials (TTM):

Revenue	$1.35 billion
Operating Profit Margin	22.0%
Net Profit Margin	13.4%

Valuation Metrics
(@3/28/25):

	TDW	S&P 500
P/E (TTM)	12.8	23.1
Forward P/E (Est.)	12.1	21.1

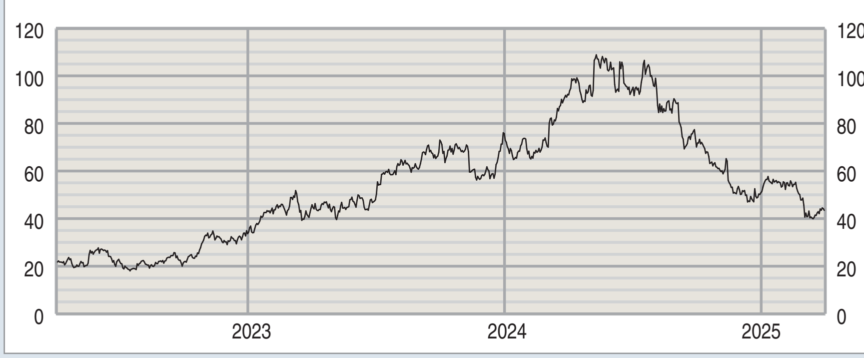
Largest Institutional Owners
(@12/31/24 or latest filing):

Company	% Owned
BlackRock	13.9%
Vanguard Group	10.7%
Neuberger Berman	5.9%
Fidelity Mgmt & Research	4.5%
T. Rowe Price	4.5%

Short Interest (as of 3/15/25):

Shares Short/Float	10.7%

TDW PRICE HISTORY



THE BOTTOM LINE

Bob Robotti expects increasing demand for offshore oil and gas drilling combined with structural limits to expanding supply in the company's competitive market to translate into a favorable operating environment for it over time. He sees a path to the company earning $1 billion in annual free cash flow – against a current market capitalization of $2.2 billion.

Sources: S&P Capital IQ, company reports, other publicly available information annual free cash. There's a lot of upside to the share price were that to happen.

What are the pros and cons from an investor standpoint of being on the board?

RR: One obvious con is the limitation on how and when I can buy or sell the stock. But I'm willing to give up that flexibility to have a seat at the table, to understand more than I would otherwise what's going on, and to hopefully add value in the process. That I have less flexibility in trading isn't that big of a deal anyway – I expect to be invested for quite a while.

You gave a talk recently titled "Value Traps Unchained," using Five Point Holdings [FPH] as a representative example. Describe why you think that will be the case.

RR: I used Five Point as an example because it's the type of company we often own with tremendous asset value that can take a very long time – too long for most investors – to be realized.

The company owns real estate in California, consisting of three mixed-use communities at various stages of development: Great Park Neighborhoods in Orange County, Valencia in northern Los Angeles County, and Candlestick and The SF Shipyard in San Francisco. The basic business model is to map out the master plans, handle all the permitting and zoning approvals, build the roads and infrastructure, and then sell the finished lots to residential and commercial builders. For Five Point, these are multi-decade projects – in dynamic, supply-constrained markets – that can go on for years before generating any positive cash flow. (Five Point, for example, burned through $600 million before it started generating any positive cash flow.) Once they inflect, though, they can produce very high levels of cash flow for a long time.

Great Park in Orange County is already well developed and well into the cash-realization phase, with probably five or six years left until it's fully built out. Valencia in L.A. County had been through a number of owners and iterations, but they started selling lots there in recent years and have a path to sell at least 1,000 per year for the next 10 to 15 years. The San Francisco project has been significantly delayed for a variety of reasons, from environmental clean-up issues that are the responsibility of a previous owner to delays in plan submissions and approvals with city officials. Progress continues to be made, though, and we expect early development work at least on the Candlestick project to start over the next year.

Home-builder Lennar has a controlling ownership stake in Five Point. Has it been a good steward?

RR: You could look at the performance of the shares since the IPO and say no, but they have stepped up. They brought in a new CEO three years ago who has proven to be a really strong operator. A potential concern with Lennar is that they are one of the largest, if not the largest, buyers of property from Five Point, which puts them on both sides of the equation. Their interests could deviate from those of minority shareholders, but so far we haven't seen anything done on this front that demonstrates this. We do like that Glick Family Investments not long ago acquired a large stake in the company and that its chief in-

INVESTMENT SNAPSHOT

Five Point Holdings
(NYSE: FPH)

Business: Real estate developer with three large California mixed-use projects underway – Great Park Neighborhoods, Valencia and Candlestick and The SF Shipyard.

Share Information (@3/28/25):

Price	**5.30**
52-Week Range	2.83 – 6.71
Dividend Yield	0.0%
Market Cap	$788.3 million

Financials (TTM):

Revenue	$237.9 million
Operating Profit Margin	28.4%
Net Profit Margin	28.7%

Valuation Metrics
(@3/28/25):

	FPH	S&P 500
P/E (TTM)	5.5	23.1
Forward P/E (Est.)	n/a	21.1

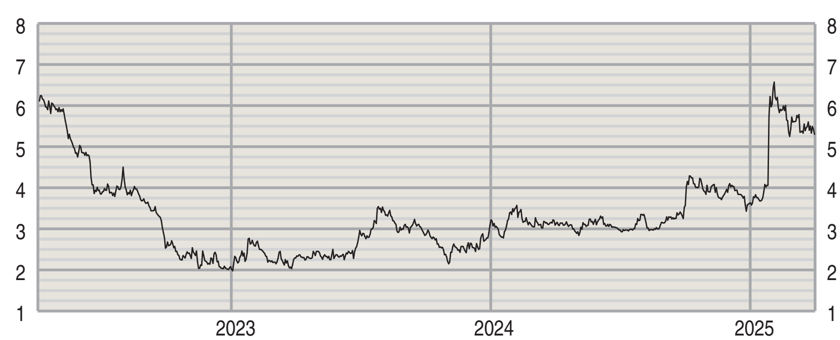
Largest Institutional Owners
(@12/31/24 or latest filing):

Company	% Owned
Robotti & Co.	9.8%
GFFP Holdings	9.0%
Private Management Group	7.9%
Third Avenue Mgmt	5.9%
Manulife Asset Mgmt	5.1%

Short Interest (as of 3/15/25):

Shares Short/Float	0.9%

FPH PRICE HISTORY



THE BOTTOM LINE

Investors are only now starting to notice the company's cash-generating potential as its long-duration real estate developments in California proceed and mature, says Bob Robotti. He believes the shares today only reflect the value of its most-advanced project, leaving the potential upside from two other, potentially larger, projects available for free.

Sources: S&P Capital IQ, company reports, other publicly available information vestment officer, Sam Levinson, was named to the board. These are serious and talented real estate people whose interests should be fully aligned with ours.

The stock chart since the company went public in 2017 isn't pretty. How do you value something like this, now trading at around $5.30?

RR: The company went public too soon for where it was in its life cycle. But now that the projects have matured and costs are better in line, it's generating more cash and the market is only just starting to notice. Basically, we think the net present value of the cash flows still to be generated by the Orange County project justify the current share price. That means Valencia and the San Francisco development – which are bigger and should each actually generate more cash to Five Point than Orange County over their lives – are options on the upside. If those play out over time as we think they can, the upside is multiples of the current share price. The timing is difficult to call, but when the upside is multiples of the current share price you can handle having a more drawn-out payoff. In the meantime, they're sitting on valuable land that is highly likely to get more valuable as time passes.

Is the balance sheet in good shape?

RR: Now that they're generating cash they've been paying down debt, with net debt now down to $150 million. They do have a fairly high-interest-rate debt issue, but that has gone from trading at a discount to a premium and they'll be in a position to refinance it at some point. That should eliminate any restrictions on paying dividends or buying back stock, both of which we'd expect them to start doing.

Has market volatility prompted you to reallocate portfolio capital in any ways of note?

RR: One challenge for a value manager investing like I do is that there haven't been capital inflows to invest. Volatility in the market is great for us because we can sell down stocks that get ahead of themselves and buy stocks that nobody cares about. Often that's the same stock. When housing was hot, we took some profits in building-materials supplier Builders FirstSource [BLDR]. Now that its shares are down a lot, we can buy it back.

For the most part we think our portfolio today is quite cheap across the board and we very much like what we own. If value by some miracle comes back into fashion, we could put any new capital to work. VII

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