MOI GLOBAL

SEACOR Marine: Undervalued, with Exceptionally Strong Management

Bob Robotti of Robotti & Company presented his in-depth investment thesis on SEACOR Marine (NYSE: SMHI) at Best Ideas 2018.

SEACOR Marine was formed in June 2017 when SEACOR Holdings (CKH) spun off its offshore marine segment. SEACOR's fleet is highly specialized. Management has an exceptional track record of financial and operational management while being excellent stewards of capital. With the stock recently trading at less than 50% of tangible book value and a significant discount to insured vessel value, Bob and his colleague, David Kessler, believe the stock is well-positioned to benefit a recovery in the offshore energy market while also providing a margin of safety. SEACOR Marine is a provider of global marine and support transportation services to the global offshore oil and gas industry, with a distinctive and non-commoditized fleet support and specialty vessels.

David Kessler of Robotti & Company also participated in this session.

The following transcript has been edited for space and clarity.

Investment Philosophy and Background

David Kessler: In order to outperform the market, you need to have one of three [types of] edge — an analytical edge, where you analyze data in a way that takes you to a conclusion before others reach it; an informational edge, where you've been able to accumulate legal information and piece it together in a way that others haven't yet; or a behavioral edge, where you're able to control your emotions and take a long-term differentiated view.

At Robotti, our advantage is that for all of our investments, we have achieved either an analytical or an informational edge, but only because of the behavioral edge that we use as a lens to view everything else. We do everything on a longer-term horizon (five to ten years), we look at different data and different information, and we can piece it together in different ways.

Jean-Marie Eveillard, a famous value investor with First Eagle Funds, described value investing as a tent with Graham and Dodd on one end and Warren Buffett on the other. All value investors who have had success with other styles have one element in common – they're all contrarian. That contrarian skill or mindset can also be extrapolated onto the management of the companies we're looking to invest in, and that's something Bob will address today.

When I had my value awakening, one of the first books I read was Bruce Greenwald's "Value Investing." At Columbia, he continues to carry on a tradition of value investing where he always talks about looking for cheap, boring and ugly stocks. But ten years later, it seems like boring and ugly is becoming old-school value investing and is being replaced by looking for more glamorous 'compounders.' While we're certainly not opposed to cheap compounders, we found that the most opportune time to invest in them is before everyone else recognizes they're compounders.

Our idea today is a company we consider to be run by a true outsider, to use modern terms. It is an asset-intensive business, operates in a highly cyclical industry, and is tied heavily to commodity, in this case, energy prices. The company also has no clear timeline or catalyst – cheap, boring and ugly. So, why do we at Robotti & Co often see value in cheap, boring, ugly and often cyclical companies and by investing in those, produce a record that we've been proud of for over 30 years?

The answer lies in understanding the value of economic cycles. I recently read a book called "Capital Returns." It's a compilation of letters by Marathon Partners, put together by Edward Chancellor, and talks about what they call the economic cycle. Let me describe it through a recent example from the US housing industry.

We've seen new entrants attracted by prospects of high returns. Starting in 2002, we saw home prices rise dramatically and then begin to fall at the end of 2006. As more capital rushed into the industry, lenders reduced rates and bent over backwards to make loans, lowering standards to make a profit. At the time the bubble peaked in 2006, the excess stock of new homes was equal to five times the annual production required to satisfy new household formations. The bubble burst quickly. Then we often see a cathartic process where industries or businesses shed assets and competition falls to the wayside, so the survivors come out with improved earnings power and a new cycle begins.

If you have a basic understanding of economics, that example would seem like common sense, so why don't more investors buy into cyclical industries instead of shying away from them? The answer lies in what Charlie Munger says about Berkshire's investment style: it's simple, but not easy.

There are many reasons why this capital cycle exists. Managers often become over-confident going into the cycle. They spend capital to increase assets, often ignoring or neglecting the competition. They also have an inside view, surrounded only by what they see, and extrapolate the recent performance into what they believe will happen in the future. Then you have skewed incentives, with management oftentimes incentivized to grow for growth's sake. You also have bankers and other investors who are sometimes pushing for the wrong incentives.

One of the reasons that people often shy away from that type of investing is that it takes experience to spot the situations where these opportunities exist, to spot the companies that are going to exit these cycles as the winners. There's no shortcut to experience. Unfortunately, it takes time. Charles Fabrikant, who happens to be the chairman of the company Bob will present, once talked in a speech about a journalist interviewing an extremely successful investor in the boat business. The interviewer began by asking his subject what accounted for his successful career in such a highly volatile segment. The reporter expected the investor to launch into a discussion of his career, but he was met with silence for several minutes. He finally got a response: "Good decisions." The reporter waited for the investor to expand on that, but when he didn't, the reporter tried to explain that he would have to write a story on this, "So maybe you could explain how you reached the decisions." Again, after a long silence, the investor looked up and said, "Experience." The reporter was becoming frustrated, knowing he needed more than those few words and so he asked, "How did you come by that experience which helped you make good decisions?" Without hesitation, the investor said, "Bad decisions." With that, I'll hand it over to Bob, who probably made bad decisions long before I met him, but we're lucky enough to learn from those.

Investment Thesis on SEACOR Marine

Bob Robotti: SEACOR Marine was spun off from SEACOR Holdings in June 2017. It has a fleet of vessels that are highly specialized. The stock trades at less than 50% of book, and that's an interesting entry point for us. Of course, trading at less than book is not necessarily a formula for immediate success or even long-term success. Other things need to be in place and for us, a key component is that the management is extremely experienced and has a great record, both operationally and in capital allocation. Charles Fabrikant has a significant positive long-term record on capital allocation. I apologize because it is a $233 million market cap company, so it's a microcap, but that's part of what comes along with investing in cyclical businesses. Small cap companies become micros, midcap companies become small caps, and they all get smaller in the downturn. Therefore, it's an attribute that investor process.

Before the spin-off, back in 2013-2014, the company contributed a significant portion of the revenues and the cash flow of SEACOR Holdings. Since the separation, it has traded down for a number of reasons. Oil prices have been going up, but the stock has traded down. I also have a large position in a company somewhat in the industry – Tidewater. People called me up and said, "Gee, this thing's trading at 75% of book." Tidewater's trading at 25%, seems like a short SEACOR Marine and go long, it's a great paired trade. A lot of pressures have gone on the stock since it's been publicly trading on its own. One of the differences between this company trading at 50% of book and Tidewater trading at 25% is that SEACOR is run by a capital allocator who's got success and a great record of understanding capital allocation as opposed to Tidewater, which is still run by the same management that bankrupted the company and lost $3 billion for shareholders. There is a difference between them.

SEACOR have vessels that support offshore marine activity, a lot of it in oil and gas. They talk about their business as distinctive and non-commoditized, but they're being a bit liberal with their definitions. There is some commoditization although it isn't as commoditized as certain other points. They have a fast boat business, a liftboat business, a standby safety business, and a wind farm maintenance business, so significant portions aren't directly related to the oil and gas business.

It's a highly fragmented industry with many different players, therefore providing opportunities for acquisitions both small and large. In this opportune time with difficult cash flows, a company like SEACOR is out looking to help consolidate the business and can make small acquisitions that help move the meter, but larger ones could also be contemplated.

An important component to the business is that it differs significantly from Tidewater, GulfMark, and the other offshore oil service businesses. Even though there are some generalities and commonalities, there are differences between the flag state, the location, the geography it works in, the size of the vessels, the design and, therefore, different niches. SEACOR has done a great job of identifying small niches, whether it's the offshore liftboat business in the Gulf of Mexico, the oil service business with a joint venture partner in Mexico, or the utility wind farm business in the North Sea. These niche businesses help with some differentiation to moderate the cash flow capital cycles.

David talked about how good decisions come from experience and experience comes from bad decisions, so here's a long-term history of oil. I was first an investor in the oil business back in the early 1970s, and I know what the business is like, how oil prices drive activity, investment opportunity and investment losses, in short, how to take advantage of that cycle. One of the things I would point out is that a lot of people have frequently said the current downturn in the energy business is the worst ever. They often make comments like "This is worse than it was in the 1980s." All I keep thinking is either they have forgotten because they're as old as me and their memories aren't as good, or they weren't around to experience it.

In the 1970s, oil prices went from flat-lining for decades at 20 and spiked to significantly over that and had two events. What you ended up with in the 1980s was a huge oversupply. The bottom was probably from 1982 to 1986 – all you had was oil going down and down. What drove the decline was the fact that the world consumed 58 million barrels a day but had the ability to produce 72 million barrels a day, so you had a 20% oversupply. When someone says the current downturn is like the 1980s, I don't see how anybody can take a 20% oversupply and compare it to two million barrels on a 94 million base, which seems to me is almost the margin of safety you need given the uncertainty in some countries that produce oil. That analogy is truly a bad one, and people make poor decisions from it.

The offshore boat business is in large part about servicing the offshore rig business. Rig utilization is an important leading indicator of the business outlook. From 2006 through 2014, the number went up pretty consistently and drove an increase in boat demand. Interestingly, it was at the beginning of 2014 that rig activity offshore started to decline, so that's got to be five to ten months before the oil price break that happened on Thanksgiving of 2014.

What had happened was the cost had risen to the level that even at $90 oil, much of the offshore activity was not economic and that economic reality started the decline in the business. Of course, the drop in the price of oil truly exacerbated the problem. Over the last year, there has been a stabilization in the offshore activity, which is essential for boat utilization. Importantly, back to that cycle of longtime on oil and gas, there's a strong conviction we have that the fundamentals are in place for continued improvement in price, and even stability at these levels is going to drive significantly higher activity.

In response to the offshore drilling activity, there is a ramp-up in the building of new boats to service the demand. Deliveries rose after the financial crisis, but those were all boats that had started to be built before the crisis happened, so commitments were being delivered in 2009, 2010, and 2011. There has since been a significant decline, and new deliveries have evaporated, so the supply side of it is no longer swamping the problem.

Back in 2008, there were about three boats for every rig, which is what you'd need. Normally, every operating rig requires three boats servicing its needs – going back and forth to shore, bringing equipment and supplies – and so you probably had full utilization. That's what drove the increase in activity and the building of new equipment. Today you have significant oversupply because the rig count is so forward and all of those vessels have been delivered. That sets you up, and SEACOR Marine is not exempt: the day rate revenues have come down to half of where they were before the decline in the cycle. Given the operating leverage of the business, that means it's gone from generating strong free cash flows to no free cash flows and even negative cash flows in certain cases.

Starting in 2015, a number of capital providers identified the business and said, "This is an interesting cycle that's repeated itself and provides an opportunity for us to buy assets at a significant discount to what their intrinsic value is." The first one was SEACOR itself: in November 2015, it entered into an agreement with Carlyle Group, which provided $175 million in the form of a convertible note. The company got seven-year cash to be able to invest with low-interest rate and, potentially getting Carlyle as an investor, look for other opportunities to consolidate the business since they thought there was a great consolidation opportunity.

SEACOR and Carlyle were not the only ones thinking there's an excellent opportunity to buy assets discounted at the bottom of the cycle. You also had Kristian Siem, who we know well through our investments in Subsea 7 and consider a great capital allocator with an impressive record. Siem partnered with Elliott Management to identify and buy vessels in the North Sea. More recently, GulfMark recapitalized its balance sheet, as did Tidewater. They are both interesting companies in that they are debt-free today, and the assets are heavily discounted from what the book value was before the restructuring. You can buy assets there at a quarter of book with companies that have a balance sheet giving them clear survivability. With GulfMark, both SEACOR and Carlyle made a bid to recap it. In the process, you also had Mike Price of Mutual Shares making a bid to buy it. In other words, there was definitely a lot of smart capital interested in being in the boat business.

You did not see attrition over the last few years – definitely in the 2013-2015 period – because activity was still strong, and even old boats that were not competitive continued to work given the demands of the business. More recently, the supply is beginning to have attrition, but that said, there's no quick attrition for the fleet. The problem is that boats themselves don't have a lot of steel value, so the scrap value is relatively minimal. Instead, a large portion of the fleet is tied up and in cold stack position where you can maintain a boat for $800 a month and so defer a decision to scrap it without significant value expected at scrapping time. That's an important component, and the beginning of the supply reduction is happening, so you'll have two things.

One, the vessels that are in tie-up – do they ever come out of it? A lot of them won't. Effectively, they'll be scrapped by being tied up. At the same time, they also see more bifurcation between the vessels themselves in terms of the capacity and capability, so the older ones also will not return to service. Therefore, the supply side of the equation appears to have begun a significant corrective process.

In recent times, there has been a stabilization in terms of activity. Therefore, taking vessels out of service has gotten to the point where it's ticked up slightly in recent periods of time. This last year, with rig activity picking up some, there's an increased boat activity, and it would appear on the horizon there'd be a significant increase in offshore activity. This should drive demand for supply of vessels that are out there, and in certain markets you've already seen it.

It's not only an age issue, but also the design of the vessel and its competitiveness in the marketplace today, so again, there's going to be the bifurcation where that will accelerate what a competitive fleet is. As the demand side starts to correct, the supply side will come into balance faster than might appear to be the case with a 3,500 vessel count. Oil and gas is an extremely capital-intensive, long-cycle business and, therefore, the replacement of reserves has dramatically and continuously declined since 2012. Inevitably, that will have an impact on a go-forward basis.

SEACOR itself has a long history, sometimes buying and at other times selling assets. One of the highlights about SEACOR Marine is that it's not like many others that love the business they're in and always want to grow. This is a business that's focused on getting returns on capital, which means being both a buyer at the right time and a seller at the right time. Therefore, monetization is an important component of why SEACOR Marine is differentiated from other competitors in its space. Since 1975, they've sold 500 vessels. Normally, people will tell you they've bought 500 vessels, but they're not going to sell them. There's a constant realization of that fact. John Gellert, the CEO, has been with the company for 25 years and he's run it since 2003, which is also significant.

Kessler: It's important to point out that Charles Fabrikant has a record. He started SEACOR in 1989, has a tremendous record of buying and selling assets at the right time and, most importantly, thinking like an intelligent investor.

Robotti: Thank you, David. When we were preparing for this, we also thought about presenting SEACOR Holdings as an idea because the link between the two is Charles Fabrikant. He's the one allocating capital, thinking about the entry of businesses and opportune times when the assets are available at a significant discount to what their economic value is, and monetizing when there's excitement about these cyclical businesses. SEACOR Holdings say they harvest gains, they don't hug assets. It's an important differentiator between many capital- and asset-intensive businesses.

In addition to being able to buy through acquisition at the low points in the cycle, the company has capex plans. It has spent money and continues to spend on new vessel buildings because there is an opportunity to build value in organic ways, too, even in low points in the cycle. The cost to construct equipment becomes extremely attractive. The ability to defer is one of the aspects that minimizes some of the capital requirements. In the fast boat business – a new budding business that is displacing the offshore helicopter business and accounts for 50% of their assets – he built a number of vessels and committed to build them based on environmental rules and changes and grandfathering in the position he had. He's going to have the newest vessel with by far the lowest cost and is therefore competitively advantaged in the marketplace.

This is not an offshore boat company like Tidewater and GulfMark. It's an aggregation of specialized businesses that play in different parts of the cycle of oil and gas, but even not in oil and gas. The wind farm utility business is about the maintenance of offshore wind farms in the North Sea, so it's a business that has continuity and consistency to it. It's quite a different business that isn't driven by the oil and gas business. The offshore wind farm business continues to grow, and that universe gets greater all the time.

The fast boat business is a displacement that is far more cost-effective than helicopters for ferrying employees back and forth to offshore equipment. These are fast boats that have all kinds of comforts and designs to them plus internet access. From an employee point of view, the wrench time differential between a four-hour boat ride and a 45-minute helicopter ride is only 45 minutes, so you're paying half the price and yet you're losing little in terms of productive man hours. The lift boat business, which is also highly differentiated, is going through tough times, but they're in the process of acquiring a joint venture through a bankruptcy process. Charles is somebody who is quite familiar with bankruptcies, knows how to work and maneuver around and use that as a tool to acquire companies and assets at a significant discount.

In terms of debt maturity schedule, the most significant portion of the debt is the convertible notes from Carlyle, which aren't due until 2022. The modest interest rate and the lack of covenant restrictions mean that even in their downturn year there is no issue with difficult times potentially causing acceleration of debt and lender discomfort. Also, back in 2103, the vessel operating profit of the business was $214 million, and the vessel fleet has probably grown since then. We're not necessarily suggesting that pricing is getting back to 2013 anytime soon, but three or four years down the road it has that potential. In the meantime, he'll continue to look for and acquire assets with significant discounts, adding further to the earnings power of the business.

Regarding the book value associated with the hard assets he has, the fast vessel support business is 50% of the assets. The book value itself is not only depreciated – given the difficulty of the business in recent years, he's written it down even further through a number of impairments. Some of those impairments, the subsequent events, and the change in the business potentially mean those are probably more aggressive than what the earnings power of the assets are. It's not just 50% of book; it's a far larger discount to what the real economic value is, including the replacement value, which is relevant over time. Supply attrition and demand growth over the next couple of years should lead to a point where you have long-term earnings power.

It's more than that. For example, even today, the number of vessels operating is probably close to the fleet that's not tied up. We already have new rig activity in the North Sea that doesn't have corresponding offshore boat activity, meaning there's demand for incremental offshore boats. You have to bring something out of layup. Bringing out of layup is anywhere from a $400,000 to $1.5 million expense per vessel, and anyone bringing a vessel out is going to be able to command a higher rate because of the demand, and then he'll also probably get contract terms. That also means that over the contract they'll be able to pay back the investment they'll bring. An inflection in pricing is already starting to happen, and once that happens to the incremental tonnage that comes back out to the surface, it will work its way through to the rest of the fleet. Therefore, one of the things you see is improving pricing and margins and all of the advantages that come from it.

We also talk about the ability to buy assets. Recently they've made a small acquisition, buying four vessels for between $7 and $9 million. If you take $9 million, the high end of that range, they paid $2.25 million for each vessel. Those were probably constructed in 2010 for about $6 million a vessel, so he's buying them for a third of what they were constructed. The vessels are in a class and at a work level that's extremely competitive in the current market, and should therefore be able to generate returns that tie back to an unlevered rate of return for that original cost.

His real intent is to try and buy those assets from others at a fraction of what their economic value is. If you build those vessels anew today, it would probably cost $17 to $18 million, so there is an organic new build opportunity given the shipyard stress. They are willing to negotiate and sell it to you at cost or even less than cost, which means you can buy it at a 30% discount. Organic opportunities exist as well as asset acquisitions, and a four-boat purchase doesn't move the meter for Tidewater, but for SEACOR, a number of those put together do have the potential. They're a competitor and because of their small size can do smaller acquisitions as well as larger ones. The larger acquisitions are likely predicated on whether Carlyle will have an interest. There was a lot of institutional interest in this business at the beginning of 2016, when people thought there was an opportunity to buy assets at a distressed value. The world is awash with capital today, so many people invested in the onshore business and got assets at a fraction of their value.

One deal we got close to was Cerberus buying the pressure pumping assets of a Canadian company for 30% of book. A year ago, they took it public at two times book, so in less than a year they had a six times return on gain because suddenly the market understood that the assets were going to be in demand again and the price started forward. The bloom is off the rose; there's been a subsiding of that institutional interest – Carlyle's interest has probably abated, Elliott has gone away, and Siem hasn't been able to buy boats. Nevertheless, the fundamentals will start to turn over the next three to six months, potentially awakening those animal spirits. The private equity market is awash in capital, and the opportunity to buy an asset at a third of what it's worth could easily rekindle that interest. That's part of the component that could accelerate the timeline in terms of a recovery.

One of the risks to the investment is oil price, and there are many reasons why it could go down. But as we said, this is a capital-intensive business with three or four years of significant underinvestment, the projects that were committed to back then are all online. Therefore, there's a dearth of new things that come online from here, the realization of the real economics of onshore production being significantly higher than what people thought a year ago. There are a number of movers, and we have a pretty strong conviction that the recent oil price strength has plenty of underlying fundamentals to it.

Ship owners themselves will delay, and the delaying of the scrapping is minimized here because the longer the vessel stays in layup, the less likely that it comes out. It's attrition on the line, and there's an argument that the longer it takes, the stronger the recovery will be. That's because more vessels will be gone from the fleet, so the supply side continues to accelerate its correction, and that's less of an issue. There are always liquidity issues. Even though the balance sheet and the cash position are strong today, continual operations over the next one to three years could expose the company in some ways.

The following are excerpts of the Q&A session:

Q: Bob, would you like to see management prioritize anything differently than is currently the case?

A: No. There's an advantage to investing in a business where you have high conviction that the management is aligned and thinking about how to create shareholder value. The management's knowledge of the business is clearly superior to mine. They understand the particulars of Mexico and the opportunity there; the JV they have with a local party gives them a local flagging and thus a competitive advantage in that marketplace; what Mexico looks like in terms of this artificial, arbitrary line drawn in the Gulf of Mexico between US and Mexican waters. On one side of it, you have significant oil and gas activity, and you would think that the geology in worlds, how oil and gas has since laid down, doesn't stop at that arbitrary line, but clearly flows over it. The opportunity in that marketplace is significant and identifiable. Pemex still has issues getting the opportunities open to others, but they have done that, too. They've let people come in.

Mexico's an interesting opportunity, and Charles is a master of the details. The devil is in the details, and he is a devil-in-the-details kind of guy. Among the things he'll do is the restructuring of the liftboat business he's buying out of bankruptcy. He's got an entity he will recapitalize and put vessels in. This could put them at risk, but he also has debt in it that is nonrecourse to the parent company.

He's making investments but limiting the risk/reward because if he's wrong on it, he will subject the company to that risk. There are a lot of particulars. Also, the way he structures deals is an important component of how he will drive value over time. He's got 50 years of experience. He's an experienced attorney and understands the nuances and particulars of the business – the Jones Act, foreign flag, how that works. With SEACOR Holdings, he's in business in Norway, he's been in business in Venezuela, he's been in odd places that he's thought about and has figured out how to have significant upsides and to moderate his risk at the entry point. He's an extremely capable, experienced manager.

Q: I see a question from a Latticework Summit participant, which is particularly spot on. Let me read it verbatim: "Thank you for this wonderful presentation. You stated that there is a sentiment for offshore activity. You covered many aspects of this industry and the company. Would you be so kind as to spend some extra time on the specific competitive advantages of this company and/or the competitive landscape? What makes a winner in this industry?"

A: An important component in a capital-intensive, cyclical business is understanding capital allocation – when to allocate capital, what's the right price, how to do it, and how to do it intelligently. That's the thing driving me here. Tidewater is in the same general area, and I also own Tidewater, but it's a different investment thesis. There, I'm buying assets at an even larger discount to what they're worth. The recap balance sheet gives it longevity that clearly has staying power to last through whatever this downturn is. But again, the management is quite different. The advantage to Tidewater now is that the management responsible for putting them in bankruptcy and losing $3 billion for investors is no longer there. They recently replaced the CEO, and that appears to have improved the situation, which is one of the dynamics.

The offshore oil service industry, in general, is probably pretty interesting. The investment community has been led to believe and has concluded that onshore oil shale is the most competitive, lowest-cost producer that can supply all the world's oil needs. That's a significantly misunderstood idea. In the meantime, the offshore business has done a lot of the same things that onshore has. The business started to slow down at the beginning of 2014, long before the break in the price of oil, because it was not competitive, the cost had gone to high.

The whole cost structure of the industry has been reset, and in that process, a significant amount of discovery made in the past had been re-worked, re-engineered, re-designed with a different lower cost structure, some of it sustainable, some not. In offshore oil, there are plenty of opportunities that are economic in the current environment. Even at $50-$55 price, there are lots of projects that are economic today. At a $65 barrel price, they're definitely economic. The activity level should pick up dramatically in the next six months, and people start to see that and have a different perception as to the whole offshore oil service business. There are different ways to play it.

Here, I have a smart capital allocator who will be able to take advantage and continue to allocate capital to further increase the earnings power of the business. He has some of these niches, but it's not only niches, it's also geographic niches. He could also convince Carlyle to get back on track to where they were earlier, that there's an opportunity at something like a Tidewater or like a GulfMark that trade at rather interesting prices and are heavily discounted, therefore deploy capital at a low point in the cycle to help consolidate the business. That could happen. There's a risk that it doesn't, so you can't make this investment predicated on the belief they'll be a major consolidator as opposed to some tuck-ins where he'll allocate capital and get quite high rates of return based on what he's doing in the next couple of years.

Q: I see another question from an MOI Global member, and it looks like a great follow-up. “Quite an interesting perspective on insiders and their history of shareholder value-driven behavior. Could you please elaborate on insider incentives and if the incentives at this company are potentially structured differently than the incentives of other companies in the industry?”

A: That’s a great question. In Subsea 7, Kristian Siem owns 22% of the company through Siem Industries. The alignment isn’t compensation of management because the last thing you want is to have an incentive compensation that you think will drive management activity. What you want is a manager who inherently understands capital allocation and is driven to do the right thing. If you want to have a carrot and a stick to make sure he does the right thing, that’s more problematic, so inherently you want the underlying capital allocator to be already aligned with you and identify that fact and, therefore, invest with it. With SEACOR, it is interesting because Charles doesn’t own nearly as much. His personal ownership of the business isn’t 20% of the company, but he definitely thinks about the stock, as well as the reputation and record. They’re an important component of his success and being a manager who will continue to compound, buy and sell assets; not be wedded to a business but be an asset allocator and a capital investor. I understand that alignment and that requirement, but sometimes it isn’t driven only by the numbers in the compensation formula.

Q: I see another question; it has multiple parts, so let me throw it at you and you can take it however you want:“Can you please speak to any spinoff-related nuances, any incentives that sandbag the financials, any wrinkles related to insider behavior, perspective on the size of the parent versus spin-off, and any possible non-economic selling?”

A: He’s done spin-offs before, so it’s in his DNA and makes sense, the idea that you would have a marine business only if you think you want to consolidate it, therefore have a security that would align with someone else. Does the seller have an offshore business and they don’t want to own stock in an inland barge business or a coastwise trade business, which is in the rest of SEACOR Holding? To keep that kind of alignment, to use it as a currency potentially to do acquisitions is one of the reasons.

A significant reason for this spin-off also was the original agreement with Carlyle on the convert. If they didn’t spin it off as a standalone entity, the convert had to be repaid after a year and a half, so the completion of the spin-off guaranteed the convert stayed outstanding. Since it is far in the money, there’s no way he wanted to return the $175 million. Completing the spinoff enabled him to lock in that convert, meaning it’s not due until 2022. That’s definitely part of the reason.

Now it is a standalone, offshore marine boat business, and two other companies in that space are US-listed GulfMark and Tidewater. You could see a comp, and that probably drove down SEACOR’s valuation also because you could buy those two companies at officially like book, but the book was restated because they both used fresh start accounting when they went through their bankruptcy reorganization. The two companies wiped out all the debt they had. They now have cash about equal to what their debt is, so they are net debt-free companies and survivability is no longer an issue.

Both of those companies traded around 25% of what the historical, discounted, impaired book value was so you could buy the assets cheaper. A number of people called me up and that’s what they did. They were shorting SEACOR Marine as it got spun off given that differential. There’s probably somebody still out there that’s got that short on and thinks, “Okay, I can go long one at 25 cents on the dollar and short one at 50 cents on the dollar.” That’s part of the spin-off dynamics, too, in terms of where it’s been trading recently. There is a history of people invested in SEACOR who think well of Fabrikant and his record, so that does provide some support. It’s part of the reason for the differential in valuation based on book basis between the companies.

Q: There is another question from an MOI Global member, and I'd like to read it verbatim. "How does the order book for new ships look right now? How quick can shipyards ramp up new supply?"

A: It's definitely somewhat of an issue. Nothing is being delivered, whatever was ordered has been paid and delivered. Orders were cancelled, but that means certain shipyards have vessels that are somewhere not completed, therefore there is a latent opportunity or risk that, as the business starts to improve, new vessels can come out and be available at a pretty significant discount. That's part of the equation that makes SEACOR interesting because SEACOR Marine would look to do that, they have historically done it – build assets where you can do it at a significant discount to what the normalized value is.

He's done it multiple times. Back in late 1990s, he built two offshore jackups that you could buy pretty much for steel value and before they were completed, he flipped them and sold them to somebody. There is some risk to it, but for SEACOR Marine, it's also probably an opportunity in terms of his being able to acquire brand new assets at discounts to what the normalized cost is. With the vessels he recently bought, it cost $24-$25 million for the four of them to be built. Today, you can build them for $17-$18 million, or a 30% discount to what it would normally cost for the replacement value. That's an opportunity and a risk because it means there'll be some vessels that probably will work into the market there and moderate some of the recovery that happens over the next couple of years.

Q: That dovetails to the next question I have from another MOI Global member. She is asking us, "Can you address which of the risk factors you mentioned you are most concerned about?"

A: Starting with oil, I think it is fundamentally strong where it is, and there's total justification for the current price. If anything, it could go higher in the months ahead. I also know from investing in oil markets for the last 45 years that I have no idea where the oil price will be within six months. I could be wrong; things could happen. In the short-term, there is definitely oil price risk and, therefore, that's a mark-to-market risk of the investment. Does it trade down to 35% of book if oil prices decline? That would probably be the case. That said, it's a more market risk. The bigger risk is liquidity, and over time that becomes more of an issue. I do think that Fabrikant's conservative in how he's allocated and financed things, so that's less of a risk, and the timeline on it is probably pretty long given the cash they have. The main component of the debt is that the debt with Carlyle doesn't come due until 2022, which provides a long window of opportunity. I don't think the liquidity is an issue that can't be handled given the current balance sheet, but over time that would become more of an issue.

About the instructor:

Bob Robotti is the Founder, President and CIO of Robotti & Company Advisors, a registered investment advisor based in New York City. Guided by the classic tenets of value investing, Robotti & Company Advisors uses a proprietary research approach to identify companies with solid balance sheets and the ability to generate significant amounts of free cash flow, yet are misunderstood, neglected, or just out-of-favor. Once identified, Robotti's investment team focuses on deep primary industry and company research to select investment holdings through the lens of a long-term business owner. In this capacity, Bob currently sits on the boards of Panhandle Oil & Gas Inc. (NYSE:PHX), AMREP Corporation (NYSE:AXR) and Pulse Seismic Data Inc. (TSX: PSD) for which he also serves as Chairman. Prior to founding Robotti & Company in 1983, he was the CFO of Gabelli & Company. Bob holds a BS from Bucknell University and an MBA from Pace University.

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