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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Focusing on Areas Where Headlines Are Creating Negativity

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SECTOR — GENERAL INVESTING

TWST: Could you tell me about the company?

Mr. Campagna: We formed Moerus in 2015 after we had worked together for many years at Third Avenue Management to be a pure expression of our investment philosophy and what we try to do. We built the business from the ground up, not taking any outside firm capital at the business level because we wanted it to be an investment-led organization, not a business-first one. We are a deep-value, long-term, contrarian investment manager. We manage reasonably concentrated portfolios of 30 to 50 securities that are global in nature and are really focused on finding what we think are the best opportunities around the world for a three- to five-year or longer holding period.

TWST: Why don't you tell me a little bit about the investment philosophy?

Mr. Campagna: We employ an asset-based approach here at Moerus in contrast to many of the other investment managers out there who look for cheap stocks on an earnings-related basis. We really try to put earnings aside and focus on what we think the company's assets are worth, not their current earnings generation. We believe that short-term earnings dislocations, be it for company-specific events, be it for cyclical events or be it for country-specific issues, that obscure the long-term value of some of these companies, create opportunities for long-term investors. A long-term investment horizon is required for this approach because we're buying things that currently look very, very negative and don't have a light at the end of the tunnel or a catalyst that's been identified.

We tend to buy things at a very, very large discount to what we think the net asset value is. And this really does two things. Firstly, it creates upside potential because you're buying something cheaply. And secondly, it actually creates downside protection, because once the expectations are washed out of a stock, there's, in our opinion, much less risk for downside.

In trying to ascertain a value for a company, we try to say, what would a rational buyer in a normal market pay, not based on current market multiples, and is this company trading at a discount to that? What would a rational buyer of the entire business be willing to pay, not in a fire sale and not in a heyday-type market but in an environment that we think is more normalized? So we tend not to use market-based metrics. We tend to use what we think are more conservative ones, based on longer-term historical metrics as opposed to what the market is paying today for a specific business.

And the last thing I'll note is that risk management is essential. We buy stocks for a three- or five-year or longer hold period, and in our history, we typically held things on average for six or seven years. When you're buying things for such a long-term time horizon and the near term does not look good and there's no clear catalyst for something to fix it, you really have to focus on risk management. And to do that, we focus heavily on staying power, be that in the form of a very strong financial position, saleable assets or other measures. We really focus heavily on making sure that the companies that we're buying are not only going to come through whatever adversity they're facing, but they're also going to benefit and possibly take some market share coming out the other end.

TWST: Did you want to highlight a stock that you find interesting?

Mr. Campagna: Sure. We tend to focus on areas of the world where headlines are creating a lot of negativity and look for assets or companies in those countries or in those industries that we think there's long-term value in. One area right now that certainly is in the headlines is the United Kingdom and Brexit, and a company that we really like in the U.K. is called **Hammerson** (HMSO LN), which is a U.K.-listed real estate investment trust. They own premier shopping malls in the United Kingdom as well as assets in France, Ireland and an interest in a Pan-European luxury outlets business.

What's interesting here is that **Hammerson** is going through a very, very tough environment, not only because of Brexit, which has sapped consumer confidence and thus spending, but also because of the penetration of online shopping. In the U.K., online penetration is about 20% of sales, which is much higher than it is in the United States, where it's about 11%. This has caused a complete and utter reorganization of the retail industry in the United Kingdom, with many retailers going through bankruptcy, and the retailers that aren't going through bankruptcy are suffering.

Now, why would you want to own a retail landlord in that environment? What's interesting about **Hammerson** specifically is that 60% of its assets are actually outside of the U.K. I mentioned that they own assets, shopping malls, in France and Ireland. And then, they own this really interesting business called Value Retail, which is a chain of premium outlet locations around the U.K. and continental Europe. That business is very high growth, tends to be much more insulated from online competition and is really tied to tourism, typically by Asian, Russian and Middle Eastern shoppers coming to Europe and buying luxury goods.

Hammerson today trades at a massive discount to what we think its net asset value is. Our estimate of NAV is around 4.50 pounds. The company, which discloses its own estimate of NAV, their appraisers think the business is worth 6.85 pounds. The stock today trades at 2.32 pounds, so a massive discount.

Now, that discount is partially warranted because in our opinion, again, market cap rates, which are used to derive the book value, tend to be a little bit lower than average and tend to be backward looking as opposed to forward looking in our opinion. And we expect that we're going to see some significant rental declines going forward. However, the magnitude of the discount is pretty immense.

Just to put that a little bit into perspective, only last year, **Hammerson** was subject to a takeout offer by a French company named **Klepierre** (LI FP) at 6.35 pounds. Now, the stock today is trading at 2.32 pounds. So you can see the massive divergence between what a willing rational buyer thought it was worth a year ago and what the market thinks it's worth today.

Looked at a different way, if you take the asset values of all the assets outside of the United Kingdom, you're paying essentially just 200 million pounds for the U.K. portfolio, which is valued at over 3 billion pounds by the company. So effectively, you're paying 6% of asset value for the U.K. portfolio. Now, while we expect that there will be continued challenges in U.K. retail, 6% of asset value is a pretty crazy number in our opinion.

Lastly, the balance sheet is strong, so we are not worried about debt issues. There are no near-term maturities. Loan to value is below 40% for the company, and they've actually been selling assets recently, which shows that there's

Highlights

Michael Campagna discusses Moerus Capital Management LLC. Mr. Campagna describes the firm's investment style as deep value, long term and contrarian. Mr. Campagna focuses on areas, whether industries or countries, where headlines are creating negativity. He uses an asset-based approach, meaning he looks at what a company's assets are worth rather than current earnings generation. Mr. Campagna has at least a three- to five-year holding period and generally buys at a large discount to a company's NAV. According to Mr. Campagna, this creates both upside potential as well as downside protection.

Companies discussed: Hammerson plc (HMSO LN); Klepierre SA (LI FP); Sino Land Company Limited (83 HK); Gran Tierra Energy (GTE CN); Aker ASA (AKER NO); Aker BP ASA (AKERBP NO); Ocean Yield ASA (OCY NO); Hess Corp. (HES US); Aker Solutions ASA (AKSO NO); Akastor ASA (AKA NO); Kvaerner ASA (KVAER NO); Solstad Offshore ASA (SOFF NO); Tidewater (TDW US) and A.P. Moller-Maersk (ADR) (MAERSKB DC).

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still institutional capital out there wanting to own these assets, at attractive cap rates, and it brings cash onto the balance sheet to help improve their financial position, further insulating them from any issues going forward.

1-Year Daily Chart of Hammerson plc

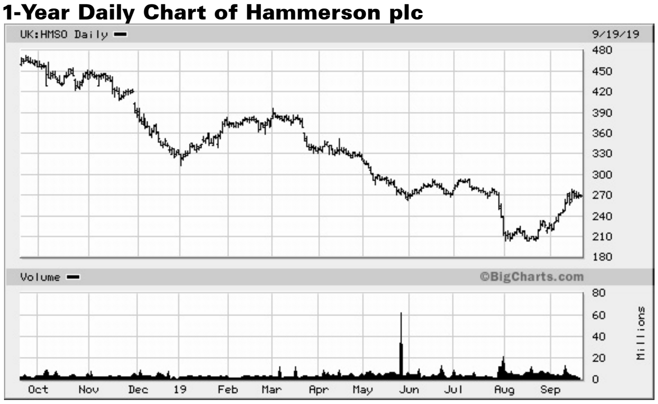

Chart provided by www.BigCharts.com

They develop properties throughout Hong Kong, condo properties for sale throughout Hong Kong and mainland China. And then, they also own an investment property portfolio across Hong Kong, Singapore and Australia, which includes malls and offices. Importantly, these malls are not the glitzy high-end luxury malls that Chinese shoppers flock to in Hong Kong but are regional malls that Hongkongers and normal everyday people in Hong Kong shop at, and a hotel chain that has locations in Australia, Singapore and now in Hong Kong as well.

What's really interesting about **Sino Land** is it's got the largest, if not one of the largest, cash positions. A lot of the discount in the Hong Kong developers can be attributed to the fact that their properties are very richly valued. Hong Kong properties are amongst the most expensive in the world. What's interesting about **Sino Land** is they've got about U.S.$5 billion of cash sitting on the balance sheet, which accounts for about 22% of their asset value. The stock today trades at more than 50% discount to that asset value. And again, 22% of that is cash.

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TWST: And something like a real estate investment trust in the United Kingdom, would it benefit from, let's say, the Brexit deal or just if some kind of a finalization of the Brexit issue came about? Would it bring confidence to the economy?

Mr. Campagna: Yes. I think in the long term, yes. We need some sort of resolution to this. And if you've been following what's going on, it's obviously chaotic and constantly getting extended. I think what has actually been really bad for U.K. retail, in general, has been the constant extension and bickering around Brexit, because when people don't have certainty, they don't feel confident spending money. So even a hard Brexit, which could be very painful, I think, for all of the U.K. in the short term, could be a benefit for this company in the longer term as consumers will then reset and be able to get back to a normal or more normal spending pattern.

TWST: Did you want to mention another company?

Mr. Campagna: Sure. Another area of the world that's been experiencing a lot of turmoil of late is Hong Kong. We've all seen what's been going on in Hong Kong with the protests. And again, coming back to our investment philosophy, we try to look for where short-term earnings issues or headlines that are very negative create opportunities for a long-term investor, and in our opinion, another opportunity is in a company called **Sino Land** (83 HK). It's a Hong Kong-listed real estate developer.

Why is that really interesting? Hong Kong is a place where land prices have historically been — and continue to be — very expensive. Prices may have recently come off because of the disruptions that have been experienced in Hong Kong. This could be an interesting buying opportunity for a company with a large cash hoard to put some of that money to work. It's almost counterpositioned to the rest of the developers. And it's a really interesting opportunity.

TWST: And in what kind of sectors are they most involved?

Mr. Campagna: Aside from residential development, which is the bulk of the development side of the business, on the investment property portfolio, they own 12 million square feet. About 60% of that is in retail and offices, followed by hotels and a little bit of industrial property. So it is pretty well-diversified from a property-type perspective. And again, it's very important to note that the retail that they do own isn't the flagship fancy malls where the Cartiers and Louis Vuittons are; these are malls for everyday Hongkongers, which insulates them a little bit better from the challenges that have been felt in Hong Kong in our opinion.

TWST: Did you want to mention another company?

Mr. Campagna: One other company that I think is quite interesting is **Gran Tierra Energy** (GTE CN). The Canadian-listed oil exploration and production company has all of its assets in Colombia and Ecuador. What's really interesting about this is that the valuation is extremely compelling.

It's trading at a discount to tangible book value, intrinsic value, proven reserves, even cash flow. It's trading at a depressed valuation, in our opinion, across all metrics. They are trading at about 0.75 times after tax 1P NAV, which is proven reserves, and about 0.3 times after tax 2P NAV, which is proven and probable reserves. The balance sheet is solid. There are no near-term maturities. Net debt is just 1.2 times cash flow. The company is self-sustaining at this point from a cash-flow-funding perspective. But it's trading at a massive discount.

1-Year Daily Chart of Gran Tierra Energy

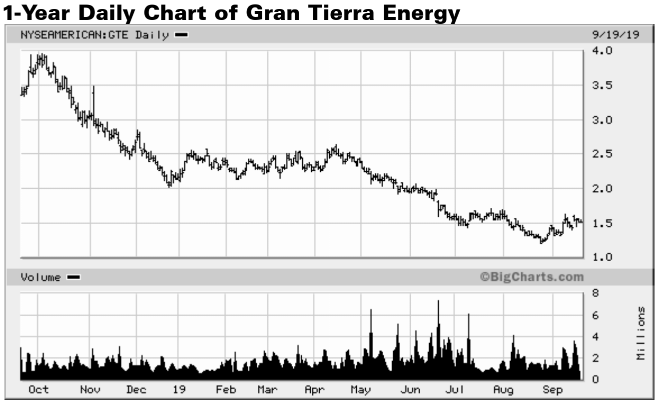

Chart provided by www.BigCharts.com

Now, why is it trading at a massive discount? Aside from global oil prices having come off a bit, the company has experienced some production issues related to its assets in Colombia. We have thought about these long and hard, and we think that these disruptions are not any sort of permanent impairment to the company but are really just a temporary impairment to the company's earnings. And last quarter, the company missed on earnings, and the stock sold off pretty hard following that announcement. But when you dig into the cause of the earnings miss, it was all about production issues, whether it's blocked roads or shortage of water or shortage of consistent electricity. All issues that they're fixing themselves by building their own generation capabilities and dealing with locals, but none of which impacts the long-term value of the assets in the ground.

What's interesting here is you're also seeing the company buying back shares. They have repurchased about 3% in the first half of 2019 alone, and the company has great staying power — their breakeven on a price per barrel of oil is below others, and almost, I'd say probably 60% of where current oil prices are. And they operate their own assets, which gives them a lot of flexibility. And this valuation gives no or little to no value to potential future exploration.

What's interesting with **Gran Tierra** is, aside from the operating assets, they also own 2.2 million acres across proven but underexplored basins. A lot of these basins are right next to Ecuador, where there are already producing assets. But because of the historic security issues in Colombia, they've been underexplored in Colombia.

Gran Tierra's management has a track record of proving up resources in this area. And we think that there's a lot of potential untapped value in this exploration asset that we're not paying anything for. We're actually getting it for negative value because we're paying a discount, in our opinion, to the operating business.

TWST: And investors are looking for untapped land where there might be some returns on finding oil?

Mr. Campagna: Yes, but the thing is, you've got to be careful that you don't pay up for those potential reserves. It's nice to have these exploration companies find large reserves, and all of a sudden, the asset in the ground becomes significantly more valuable. But if you pay up for that and those reserves are not discovered, you're at a loss. If you pay a negative value for the exploration or next to nothing for the exploration asset and something is discovered, that's a massive win for you. If you pay next to nothing for exploration assets and nothing's discovered, it's not a loss for you because you didn't pay up for those assets.

TWST: Is there one final company you would like to discuss?

Mr. Campagna: Yes. **Aker ASA** (AKER NO) is a Norwegian-listed holding company, which operates across multiple sectors, but it's heavily involved in energy and energy services as well as shipping. What's interesting about **Aker** is — as you're probably aware — energy is an area that's been going through turmoil for the past five or six years, creating a lot of challenging situations, and consequently, a lot of energy services companies are going bankrupt or are experiencing significant distress. What's interesting is, **Aker** is a cashed-up holding company in that environment.

It is run by Kjell Inge Rokke, who is the largest shareholder and has proven his ability to add value over the past 10 years. So over the past 10 years, he has generated more than a 20% annualized shareholder return. And a lot of that has been derived from taking advantage of dislocations in the energy markets or in the shipping markets and spotting opportunities and exploiting them. And we think that he is going to be able to do this again today.

We've seen transactions where **Aker** has either recapitalized or combined or contributed to or done other interesting transactions with companies that were either in distress or going through a kind of depressed, cyclical environment. Yet, we're actually still getting it at a discount because it's trading at a 20% discount to its net asset value. Now again, the company has almost $1 billion of liquidity.

And the rest of the assets or almost all the rest of the assets are listed companies or stakes in listed companies. The discount is not a theoretical discount, where they slap a high valuation on one of their privately owned businesses and we are buying at a discount to that. The discount is actually a discount to, again, predominantly freely traded securities on large exchanges that you can point to today.

But what's really interesting about **Aker** is, again, the value is not in buying at a 20% discount to NAV. The value is in Mr. Rokke and what he can do to create future value and the future value that's potentially sitting in the company. So aside from its two cash-flowing businesses, which is an ownership stake in **Aker BP** (AKERBP NO), which is an exploration and production company, and **Ocean Yield** (OCY NO), which is a shipowner that rents its ships to end users on long-term leases, they also have several other areas where there's potential significant upside.

They also own **Aker Energy**, which is carried at very little on the balance sheet, which is an African oil play. They bought it from **Hess** (HES US) for cents on the dollar of what **Hess** paid. Also, **Aker Solutions** (AKSO NO), **Akastor** (AKA NO) and **Kvaerner** (KVAER NO), which are three oil services companies that are heavily leveraged to a recovery in oil prices and an offshore drilling recovery.

And then lastly, they have an interest in **Solstad** (SOFF NO), which is an OSV company. And last time when we spoke to *The Wall Street Transcript*, we talked about **Tidewater** ((TDW US), which is another holding in our fund. **Solstad** is a competitor to **Tidewater**. And it's also levered to a potential recovery in that business.

TWST: And shipping is a field that has promise?

Mr. Campagna: Yes. I think the shipping industry has been depressed. But typically, that's a little different from what we're talking about here, which is not container shipping. The container shipping industry has been impacted, obviously, by the U.S.-China trade issues and just general slowing economic activity around the world. **Ocean Yield's** ships are more focused on industrial shipping, crude, dry bulk and, to a lesser extent, containers. So it's not a container shipping company in the same way that **Maersk** (MAERSKB DC) or another large shipping company would be thought of.

TWST: And when you talk with investors, what's on their minds as they watch the market? There have been some volatile days as we talk here in the beginning of September. What are investors concerned about?

Mr. Campagna: I think everybody's focused on the trade issues and what's going to happen next. A lot of people spend a lot of effort forecasting the future, and the market seems to be bouncing between euphoria whenever there's a President Trump tweet about a development in the trade agreement with China to pure pessimism or apoplectic attitudes following the actual fact that there has been no progress toward a trade agreement. I think a lot of people spend a lot of time trying to forecast what they think is going to happen in the world.

For us, that's something that's above our pay grade. We don't seek to forecast. We don't seek to try and say what's going to happen. We seek to buy assets that are cheap based on what is today. We appreciate the challenging situation and obviously follow the macro very closely. But simplistically, we just seek to buy assets that are trading at cents on the dollar.

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Now, the last thing about **Aker** that I'll mention, this is not a bet on a recovery coming in six months or a year or us calling oil prices or any of that; this is really an investment that's based on the fact that we believe that ultimately there will be a recovery. There's been a significant drop-off in offshore exploration spending since 2014, which started ahead of the collapse in oil prices. The offshore replacement ratio today is at the lowest it's been in 20 years. That's the ratio of new oil discoveries to oil that's taken out of offshore wells. It's at 41%, which again is the lowest it's been in 20 years.

Breakevens for offshore products have fallen from $64 on average in 2016 to about $43 on average today, which is obviously below where oil prices are. And lastly, oil majors are cash flowing today. And we've seen, to put it nicely, some challenges in onshore fracking. So we think that there is a good potential that the oil majors will look to increase their offshore exploration to help supplement production declines.

TWST: And where are they involved in shipping, what parts of the world?

Mr. Campagna: It's mostly in Europe, in the North Sea. But their ships operate in many areas of the world. And then, same thing for the energy business. It's primarily North Sea, but they also have operations throughout other areas of the world.

TWST: Is there anything we didn't bring up you care to mention, either about the firm or some trends out there?

Mr. Campagna: The last thing I'd mention is Moerus is a completely employee-owned firm. We started, again, as I said, just four years ago, and we built the firm really to be an investment-led organization. And what I mean by that is, investment management is obviously a business, and it can be a very profitable business. What we've seen in many instances, where people have become successful from an asset-gathering perspective, is the focus shifts from investments to further asset gathering.

And we've taken active steps, be it the partner committee being completely comprised of investment professionals, focusing only on one product as opposed to product proliferation, not actively marketing aggressively but spending a lot of time educating people like yourselves and our clients. We spend a lot of time trying to build road maps that will keep us focused on the portfolio first and foremost as opposed to the business end of things.

TWST: Thank you. (ES)

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