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Value times three

"Cash is now 62.8% of our portfolio," Mitch Cantor, portfolio manager with his wife, Patricia Coronado, of Mountain Lake Investment Management, advised the *Grant's* conference-goers. "Our previous cash peak was 54%, 15 days before Lehman filed."

This not obviously bullish overture preceded the presentation of three long equity ideas: Owens-Illinois (OI on the New York Stock Exchange), an asbestos-scarred manufacturer of glass bottles; Koppers Holdings (KOP on the NYSE), a banged-up maker of railroad ties and performance chemicals; and Tidewater Inc. (TDW on the NYSE), owner and operator of a fleet of offshore service vessels for the shell-shocked oil and gas industry. Not one of the three companies was easily confused with Facebook.

A "century-long roll-up" was how Cantor described Owens Illinois, which bought and—in 1958—sold an insulation manufacturer. The insulation contained asbestos. Sales of the tainted product during 10 years of OI ownership totaled $40 million. Payments by Owens-Illinois to the victims of asbestos-related cancer have come to $4.4 billion.

In 1987, KKR took Owens-Illinois private in a $3.7 billion transaction. "Today, on a good day," Cantor proceeded, "the market capitalization is $3.8 billion, less than their cumulative asbestos payments. Almost three decades of nothing. In the recent decade of nothing, there has been no stock price increase, no common dividends, no corporate actions, no spin-offs, no splits. . . . Nothing. I remember, as a research analyst in the 1980s, being impressed that Sears had a zero return for two decades, and I wondered how that was possible. Sears didn't make much money. That is not true of Owens-Illinois."

A maker of glass bottles—its only business these past 10 years—OI makes good money. True, our speaker allowed, the demand for glass bottles doesn't grow, but the business generates cash. It does not generate competition. In North America, Owens-Illinois owns a 40% market share.

Where has the cash gone? To restructuring, debt reduction and the asbestos victims. Not for much longer, though. Restructuring charges are complete, debt is under control (with a current leverage ratio of 2.4:1), and large asbestos payments "will not be a way of life for the company much longer," said Cantor. On Feb. 4, the company disclosed its intention to repurchase $100 million of stock under an accelerated buyback program.

The recent history of Koppers, the railroad tie and performance chemicals' play, features an ill-timed acquisition, an accession of debt, a reduction in cap-ex, a quarterly earnings miss (the eighth in a row), a CEO's resignation, suspension of the dividend—and, in a few short months, the halving of the share price.

The yet unwritten history, our speaker ventured, will feature heavy cash generation, balance-sheet repair and—at length—a rising share price. The company has "two lovely businesses. . . and another business," said Cantor. That other, carbon materials and chemicals, has suffered with the plunging oil price.

Cantor sang the praises of rail ties: "There are no competitive products, there are no reasonably priced substitutes. You can't use cement because it breaks from the vibrations, and there is insufficient hardwood outside North America to create a competitor." Return on invested capital tops 30%.

"The performance chemicals' acquisition last year caused the debt to balloon," our speaker went on. "But it is a terrific business. The unit sells MicroPro-branded treatment for outdoor decks to wood treaters. It is a blending operation, not a distilling operation. It does not require a lot of capital. The company is the dominant provider, and they license their product to the No. 2 company."

"Summing up Koppers," Cantor said "the company has replaced the profitability from a cyclical, capital-intensive business with that of steady, high-return businesses."

Tidewater, the offshore oil-service company, almost made Koppers look mainstream. No one at the Plaza needed to be reminded why the Tidewater share price has been crushed. For the first time in company history, operating margins have dropped to the single digits. People rather needed prompting as to the strong points of the situation.

The most important, our speaker said, is the quality of Tidewater vessels and service. "Platform supply vessels may be a commodity, but Tidewater gets a better contract and a better price because of its operating skill." A $5 billion fleet-rebuilding project is largely complete and $2.5 billion of tangible equity compares to a $1.2 billion market cap (which has risen by 9% since Cantor spoke). There are no significant debt maturities till 2019 and—a sign either of the bond market's conviction or its Fed-induced torpor—the company's five-year notes are priced to yield less than 3%.

Yes, Cantor wound up, free cash flow is, for the time being, negative, but it will turn positive come July 1. You can make the case for a 20% free-cash flow yield starting six quarters from now—which case Cantor did proceed to make.

And he closed: "Chickens that we are, while we own Tidewater, it's our smallest position."

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