

Tidefall Capital LP
Q1 2024
April 21, 2024

	Q1 2024	Year to Date	Since Inception (Jan 21, 2020)	Since Inception CAGR
TIDEFALL LP (Net)	4.4%	4.4%	205.4%	30.5%
S&P (TR)	10.6%	10.6%	68.8%	13.3%
TSX (TR)	6.6%	6.6%	43.8%	9.0%

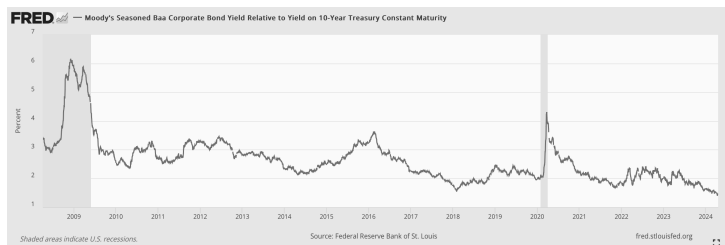
Having just finished Fairfax's investor week in Toronto, I thought it would be helpful to recap the events and how we view the positions today. First off, there was the Fairfax India AGM at the Ritz Carlton. As always my focus was on the 64% ownership of Bangalore International Airport (BIAL), which is by far and away the largest and most important asset in the holding company. Bangalore is the Silicon Valley of India and where tech companies are increasingly moving manufacturing to as relations with China deteriorate. With the fastest growing G-20 economy and just 2-3% of its citizens having ever been on a plane, passenger volumes are expected to dramatically increase in India; from 208mn in 2019 to 510m in 2030. BIAL had a big win this month when it announced that it would become Air India's second hub which bodes well for more lucrative international travellers.

The 2023 Fairfax India letter had disclosed that with the new opening of Terminal 2, BIAL was likely trading for just 9.5x normalized free cash flow. Airports are notoriously difficult to value due to control periods and by claiming a normalized figure, Prem is essentially saying that not only is BIAL one of the best positioned and fastest growing airports in the world, it is also on their books as one of the cheapest (the top 10 airports in the world have a median PE ratio of 27x). BIAL is currently on Fairfax's books at an implied valuation of \$2.5bn, a 33% increase from its value in 2022, while its closest Indian peer has more than doubled. The CFO disclosed in the Q&A section that they use discount rates in their valuation that are as high as 16% to be conservative. We believe that Fairfax is actually doing shareholders a favour with what they call 'a prudent valuation', as any write up in the asset value would increase their own fees as managers. An eventual IPO, which they recommitted to at the AGM, will see the true value flow through to shareholders and I'm very confident that BIAL is worth substantially more than the current recorded value. During the pandemic, the slower growing Sydney airport which had 38 million passengers in 2023, nearly the same as BIAL's 37 million passengers, sold for \$17bn (49x 2019 pre-covid earnings), seven times BIAL's private valuation. BIAL has far better prospects given its passenger capacity should reach 90 million in less than 10 years. Fairfax India remains a fantastic value proposition for capturing the rise of India which is expected to become the world's third largest economy by 2027. With a market capitalization of \$2bn for Fairfax India and a valuation of \$1.5bn for all of their non-airport net assets, investors are paying approximately half a billion for their 64% ownership in BIAL, an investment that we believe is likely worth multiples of that amount.

Next was the YYZ stock pitch event at the Fairmont Royal York. The top two winning presentations got to present at the dinner that night and thankfully my pitch on British American Tobacco made the cut. We have uploaded a copy of the [audio and slides online](#) and have previously written on the stock in the [Globe and Mail](#) and our [Substack](#). Wrapping up the week was the Fairfax Financial AGM at Roy Thomson Hall. With the shares up 3x since our purchase in late 2021, it's an obvious question if they remain as attractive today. I absolutely believe they are.

There are two main points that I think are under appreciated about Fairfax in 2024. First, is the value of the insurance float. Float is a term used to represent the money that insurance companies can invest from policyholder premiums ahead of any claims. Fairfax's investment float per share has increased from \$935 in 2021 to \$1,525 today. At the same time, interest rates have increased across the yield curve, for example, the 2 year bond yield moved from 0.2% at the time of our purchase to 5% today. While interest and dividends have increased from an annualized run rate of \$466mn to an astounding \$2.15bn at present. What's so wonderful about a well run insurance company like Fairfax is not only do they make money on the float but since their claims are less than the premiums they take in, the cost of this float is actually negative!

Secondly, the bond portfolio at Fairfax is highly conservative and this provides incredible optionality should the economy fall into recession. As can be seen in the chart to the right, the yield spread on corporate bonds, meaning how much investors demand to take on the additional risk of lending to a business instead of the US government, is at a historic low. Similar to how Fairfax wisely didn't reach for yield during the era of low interest rates, they are neither reaching for yield at low corporate bond spreads. If there is a period of severe economic distress, this would very likely see the yield spread on corporate bonds spike again which would give Fairfax the option to move into higher yielding corporate bonds, further increasing interest income.



Interestingly, Fairfax has now grown to the 26th largest company in the S&P/TSX Composite, yet it is still not in the TSX 60. Any potential inclusion into this index would see a rush of buying from fund managers to make sure they were not underweight. Fairfax today is trading just under our estimate of 2024 book value and 6.7x earnings.

If we review these disclosed positions and compare it to the S&P 500, we can see how strikingly different Tidefall is to the index or nearly any other portfolio manager. For example, the earnings yield on the S&P today is just 4%, if we incorporate the new T2 terminal at BIAL, the median earnings yield on the investments above is a massive 15%. As Buffett has said, "the critical investment factor is determining the intrinsic value of a business and paying a fair or bargain price." I am very confident that the Tidefall portfolio today is in bargain territory.

Trevor Scott

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