SeaBridge International Strategy

Second Quarter 2016

Commentary

The BREXIT jolt at the end of the quarter was disappointing in that it reversed the steady advance the portfolio was making earlier in the quarter. A likely outcome of Britain leaving the European Union is slower world economic growth. Companies will have to demonstrate their earnings resilience in a challenging environment. If our companies can deliver on projected forward earnings growth of roughly 15%, the portfolio should do well. At the same time, Brexit and the slower growth world that accompanies it encourages a reconsideration of yield within the portfolio. If we conclude that companies' growth prospects are dimmed by slowing economic conditions, we will make adjustments to our holdings with a bias toward strong free cash flow and a reliable dividend payout.

During the quarter, our Japanese holdings (which make up about 10% of the portfolio) were by far the best performers with four of the five holding gaining as a group about 20%. Yen strengthening 10% against the dollar during the period was a nice tailwind for these holdings. The top two performers were **Misumi Group** and **Zojirushi**. Misumi is a hybrid distributor and manufacturer of factory automation and die components. The company has been aggressively expanding its e-commerce platform (called VONA) in order to facilitate the distribution of multi-million SKU's in the company's catalog. We believe the consolidation of the wholesale and retail segments of the market along with the buildout of an e-commerce capability will be very beneficial for Misumi. Zojirushi is a well-established Japanese manufacturer of rice cookers and stainless steel flasks. Currently, the company generates 70% of its sales from Japan where it has a leading market share of 25% in rice cookers. We think Zojirushi has a great opportunity to grow in the Chinese market, where the middle to high income consumers have a strong affinity for high quality "Made in Japan" consumer products.

One of the better performing themes in 2Q16 was our investment in global and emerging market consumption. Our consumer discretionary, consumer staples, and auto component companies, comprising about 25% of the portfolio, performed well. We think the U.S. consumer is in good shape with the demographics of housing a major driver of spending. Our foreign consumer holdings (**Man Wah**, a Chinese recliner chair manufacturer selling in China and the United States; and **CP ALL**, a Thai convenience store operator) are both growing well. **Delphi** is the former General Motors parts supplier which specializes in products related to fuel economy, safety, and lower emissions. There are some concerns about the pace of auto sales growth in the coming years due to the questionable auto loans that have pulled demand forward, but the stock is very cheap and we believe its specialty products will help the company grow faster than the overall auto market.

Technology - hardware, software, and services - is our second largest exposure at approximately 20% of the portfolio. This includes core positions in **Apple** and **Google** as well as **Microsoft**, a major player in cloud databases. We are positive on Microsoft because of its favored position among cloud service providers and attractive valuation. We also have **NXPI** and **Broadcom**, which are specialty chip companies with big exposure in autos, the internet of things, enterprise networking/storage, and mobile phones. With the exception of Broadcom, these stocks hurt performance during the quarter as money moved away from the tech giants and chip makers. The technology category also includes **TenCent** and **Naspers**, the South African venture firm that helped found TenCent. Both of these added to overall portfolio performance. We also bought a position in a Japanese company **Softbank** which, like Naspers, funds high tech startups around the world (it is a major owner of Alibaba in China, which it funded at the start-up.) We think that our world is driven by technological change, and are attracted to the leading companies in their segments. However, tech stocks can be very volatile and, with a possible recession in Europe, we are considering trimming these positions.

Biotech and Health Services comprise our third largest exposure at approximately 13% of the portfolio. Although we believe this is a strong growth area in the coming years, the stocks have been derating in this political season as both Presidential candidates rant against high drug prices. We will watch political developments closely. If we conclude that the strident rhetoric is leading to some form of government price control of pharmaceuticals, we would likely reduce our exposure to the sector.

We have two cable companies, totaling a little over 4% of the portfolio led by John Malone, a cable pioneer and an iconic figure in the industry: **Liberty Global**, (Malone's largest cable company in Europe); and a spin off from Liberty Global, **Liberty Global LiLAC,** its Latin American cable company. Liberty Global neither added nor subtracted from performance after accounting for the value transferred in the spin off. LiLAC, on the other hand, was one of the poorer performers in the portfolio. We believe that a portion of this underperformance is due to the fact that many Liberty Global shareholders received a meaningful amount of this much smaller Latin America company in the spin off, and they were either not familiar with it or it fell outside their investment mandates, creating temporary selling pressure. We expect LiLAC to grow rapidly via bolt-on acquisitions and achieve the scale necessary to create a sustained advantage in the cable industry. The internal cash flows of these companies give us confidence that John Malone can compound capital in the cable business at the level of his enviable long term track record. Still we will monitor these positions closely to ensure that Malone's customary maneuverings in the capital structure of his firms continue to compound capital as in the past.

We have 11% in financial services. Although sizeable given the challenging environment, we take comfort that our holdings generally are very inexpensive by historical standards. **MasterCard** is a growth story trading at an attractive multiple. **Fairfax**, a Canadian insurance company run in the manner Warren Buffett runs Berkshire, has compounded its net asset value at roughly 15% over the years. Currently it has a "slow growth" bet on within the firm which should do well if the world slows down. We like it as a hedge to some of our other growth stocks like MasterCard. **AIA Group** is the largest Asian life insurer with broad diversification throughout the entire region. Long term growth prospects are excellent. The company has a strong balance sheet and is well run. Although we trimmed AIA during the quarter on China's efforts to stem currency outflows to Hong Kong Dollar insurance policies, we still feel it is a good long-play on the growth of the middle class in the region.

HDFC is our expensive financial services holding. It is the best bank in India, with substantial wholesale and retail operations and, as such, we think the valuation is warranted. Additionally, we believe that HDFC has low non-performing loans, which are the nemesis of other Indian banks. Both HDFC and AIA had a good quarter and were positive contributors to overall portfolio performance.

Finally, a word about our largest frustration – an alternative energy holding. **SunPower,** the top solar producer in the U.S., has been a drag on portfolio performance. The industry is experiencing some teething pain and SunPower has gotten caught up largely in bad sentiment. We are still positive on the stock and continue to hold it in the portfolios. We are encouraged by recent developments including the overturning of an adverse court ruling concerning the feedback of residential solar power to the power grid. However, we will be keen observers of developments affecting industry dynamics which, in this political season, are very fluid and we will adjust our stance toward the company accordingly.

We plan to harvest tax losses for taxable accounts where appropriate before year-end.

Dave Descalzi is a signatory to this letter, reflecting his increasing role in the management of the international and ESG portfolios at SeaBridge. Dave brings 22 years of experience in managing Asian portfolios as well as a number of years as an international manager. We look forward to adding his insights into the ongoing construction of the portfolio.

Garnett Keith
Matt Falkowski
Dave Descalzi
7/5/16