SeaBridge Investment Advisors, LLC

SeaBridge Longview Strategy

Third Quarter 2016
Commentary

The Longview Strategy performed well in the quarter. Before diving into details, it is useful to look back at the prior two quarters to provide context.

The first half of 2016 was a very volatile period in global security markets. The first quarter began with digesting the first Fed rate hike in nine years as well as the possibility of four more throughout 2016. Both the Chinese equity market and currency were under considerable stress. Commodities were rapidly declining and making new lows. Continued assistance of easy monetary policy across the globe and China's injection of $1 trillion into their economy quickly calmed investors and markets were able to gather positive momentum. Aside from a volatile week of trading following the surprise Brexit vote at the end of the second quarter, markets have generally maintained this slow momentum upwards through the end of the third quarter. This last three-month period has been generally light on globally significant macro data and has lacked any notable market shocks.

In last quarter's letter, we highlighted the four Venn Rings (Guru Ownership, Business Quality, Leadership, and Valuation) that are at the core of Longview's investing style. We also touched on the reality that many things outside the four rings were influencing the short term fluctuation in stock price (e.g. first quarter rotation to the "safest" parts of the market without regard for valuation; collapse in commodity prices; Brexit's effect on holdings with significant revenue in Europe). Although we try to mitigate this volatility to the extent possible, our focus is on maintaining the discipline of the core bottom-up stock picking generated through the Venn Rings approach.

While we are keenly aware that the portfolios will have to deal with more of these exogenous factors in the future, we welcomed the calm third quarter. Essentially, it allowed the compounding of intrinsic value at the company level to drive performance rather than outside events. A focus on cash flow is at the heart of our Longview process.

This is the first quarter since inception of the Longview strategy with no purchases and sales, although there are some new names in the portfolio due to corporate spin-offs. Although this is not the norm, it is closer to the way the strategy is intended to be managed. As the name Longview implies, we are looking to hold companies with strong franchises and good managements over the long term versus renting stock for the short term. We continue to maintain cash levels near the highs for the year. We are comfortable having an elevated level of "dry powder" due to the scarcity of bargains in the market. We also anticipate increased market volatility during the lead up to the November Presidential election and Fed decision in December. We hope this will give us the opportunity to increase current holdings and/or initiate positions in new companies at attractive prices.

As with last quarter, there was once again corporate activity in the John Malone-led Liberty holdings. **CommerceHub Class A & C** shares were spun off from **Liberty Ventures**.

Looking at the top two and bottom two performers for in the portfolio can help explain the majority of performance for the quarter. The outperformance of **Liberty Media** and **Liberty Ventures** (including the CommerceHub shares) more than offset the underperformance of **Liberty Interactive (QVCA)** and **Calpine.**

The biggest winner, up close to 50%, was **Liberty Media**. Significant changes have occurred in the stock during 2016. Prior to June 2016, **Liberty Media** consisted of stakes in satellite radio provider (SiriusXM), concert venue and Ticketmaster operator (Live Nation), and Major League Baseball team / surrounding real estate (Atlanta Braves). In June, each of these were reorganized into separate stocks. **Liberty Media** was left with the Live Nation asset. The stock was up post spinoff. In early September the company announced the acquisition of the auto racing entity Formula One. We view this as a very positive acquisition and so did the markets, rewarding the stock with an additional pop of roughly 30% in the weeks following. This will add a premier branded asset to the portfolio. Liberty brought on Chase Carey, who was a long-time understudy of media mogul Rupert Murdoch and worked with John Malone at DirectTV, to run the company. They paid what we believe to be a reasonable price given the ability to expand the race count and significantly increase monetization in the digital world (where Carey should shine.) With Formula One being 2-3 times the size of Live Nation, this will now be the flagship asset of **Liberty Media**. Given that it has such strong marks in all the Venn Rings, we are quite pleased with this development.

Liberty Ventures (including spun-off **CommerceHub**) was up roughly 20% for the quarter. This vehicle held passive interests in Expedia, Charter, Interval Leisure Group, Time Warner and LendingTree as well as active interests in CommerceHub, Bodybuilding.com, Evite, and Right Start. **CommerceHub** enables retailers to rapidly expand their online product offerings without taking on inventory risk. When a customer orders a product from a retailer's website, the product is shipped directly from the manufacturer to the customer without the retailer ever buying, stocking, or shipping it.

In the minus column for the quarter is **Liberty Interactive (QVCA),** with a 25% loss. We are still positive on the televised shopping programs, websites, and mobile applications as well as the loyalty of customers which gives the company the feel of a business with subscription-based revenue. The stock got hit after the 2Q earnings call when management said revenue from the US business segment was starting to slow near the end of the second quarter. Even though US segment posted revenue growth in 2Q, management implied that 3Q is going to have both a revenue and OIBDA (Operating Income before Depreciation and Amortization) decline which has not happened since 2009. An analyst at a recent Goldman Sach's Conference asked the CEO about the possibility of Amazon or another e-commerce player undermining QVC's market strategy. He responded, "*The QVC model, which has been around for about 30 years has been proven to be quite resilient and has absorbed many changes in the marketplace whether it be going to multichannel, or the Internet, mobile, all of which have been absorbed. I think we've seen some changes over the last quarter or so around some promotion, around some self-inflicted issues around returns and perhaps some merchandizing, but we don't see any evidence of continuing declines below this level. In fact, we see some green shoots suggesting upside*." Another reassuring factor in the QVC business model is the consignment nature of their inventory. If the reason for the revenue decline is a bad product mix, QVC should be able to correct the problem without a painful inventory liquidation.

Garnett Keith
Matt Falkowski
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