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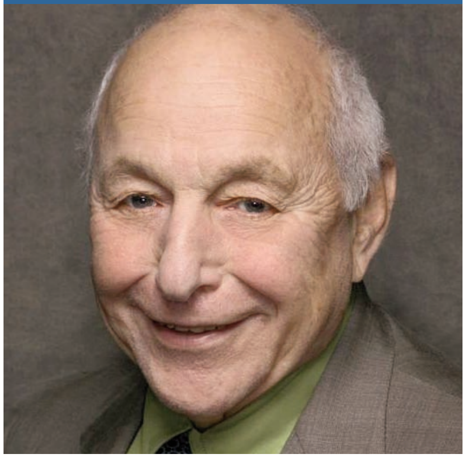
Adviser Q&A

Whitman Sampler Of Value Stocks

By Matthew Schifrin, Electronically reprinted from October 14, 2008

Marty Whitman



Few investors in the market today are as bear-market-seasoned and savvy as Marty Whitman, 84-year-old founder of M.J. Whitman LLC, chairman and founder of Third Avenue Management and portfolio manager of Third Avenue Value Fund. Like Sam Zell, Leon Black and Eddie Lampert, Whitman's roots are in distressed-company investing.

Investors in distressed assets, also known as "vultures," prey on ailing companies and buy up their debt or equity for pennies on the dollar. They're hoping to gain control in any restructuring and make windfalls when the assets either appreciate or are sold.

Today, Whitman mostly focuses on his firm's flagship Third Avenue Value Fund (TAVXF), which typically devotes only a small portion of its holdings to distressed securities. However, given the market sell-off, Whitman believes we are now seeing distressed prices on perfectly sound companies. He is pounding the table to buy, and most of his enthusiasm is in stocks his fund already has big positions in.

His Third Avenue Value Fund takes a global approach to buying undervalued assets, with a keen eye to determining realistic net asset values (NAVs). As of June 30, some 28% of TAVFX's portfolio was in Hong Kong-based companies, 13% in Japanese companies and 11% in Western real estate and private equity companies.

Given this asset mix (and the implosion in real estate and credit markets) it's no wonder his $7 billion Third Avenue Value Fund's NAV is down 40% since January 2008.

Whitman spoke with Forbes.com recently about his top 10 picks in the current market. All of these stocks can be found in the Third Avenue Value Fund, and all have had deep corrections.

Forbes.com: The market has been brutal for investors and to Third Avenue Value Fund. Have you been pulling back or buying?

Whitman: This is a once-in-a-lifetime opportunity. It's even better than the '70s. Certain common stocks are being given away. It is absolutely a time to plunge in.

But we restrict ourselves to common stocks selling at huge discounts to net asset value and the most important thing is that we are not going to go into any companies that need any access to the capital markets. They have to be super credit-worthy. We are also looking for companies that have long-term very promising businesses selling at a huge discount and that are going to increase net assets on a more than double-digit basis over the next five years. This is a very rare opportunity.

Value isn't sufficient anymore–you need value plus creditworthiness. Who knows how long the market will remain chaotic. This seems to be an opportunity like 1932 or something. We have the best companies in the world selling at a 60% discount to NAV or eight times earnings.

Most value investors are very income-statement-oriented, low price-to-earnings ratios, etc. What about now?

The balance sheet has always been paramount for us. We just don't do common stocks unless the company is very,

very well financed. The investors who can take advantage of these opportunities have to be cash buyers and long-term "buy and hold." If you are on margin or if you have a sudden-death date, I think it is pretty hard to take advantage of these opportunities. If you are like us, this is an unbelievable time.

So is your approach to finding value stocks classic Graham & Dodd analysis?

Our approach is an updated version of Graham & Dodd's theory that looks at "net-net" stocks as being the best bargains. Net-net is when the market price of common stock is less than the share value of current assets minus all liabilities. Our approach is different because we only invest when the company has impeccably strong finances, and while G&D looked at current assets, we look at high-quality assets no matter where they are on the balance sheet.

Office buildings in China owned by Henderson Land are an example of high-quality, non-current assets. Graham & Dodd's theory is flawed, in our opinion, because current assets include inventory, and in many cases, those current assets are the worst kind of fixed assets. They are subject to obsolescence and markdowns. Just look at K-Mart or Kohl's.

You are one of the few people with history in this market, having lived through bear markets like the 1970s. Is it different this time?

At the time you live through them, they always seem much more severe. That said, I think this is really the case this time. It has been worse than 1974. In 1974, I said things could never get worse. It is the same kind of thing.

Let's talk about some of your current favorite buys.

Toyota Industries

We have a big position in Toyota Industries. Nobody is thinking of what happens if Ford or General Motors or Chrysler stops making cars. What would happen to Toyota's market penetration? In any event, Toyota Industries is a large shareholder in Toyota Motors. At a recent price of $23, you are basically getting the value of Toyota Motors. Toyota affiliates have a market value of $8 to $9 a share, plus you get Toyota Industries' other magnificent worldwide operating businesses, which have operating income of $800 million to $900 million. In other words, you get a minimum of $20 of additional value for free, when you buy Toyota Industries at current prices. Total value is thus around $40, and the stock sells for $23.

Investor AB

This company is essentially a European private equity company, and the Swedish Wallenberg family controls it. In their last quarterly report, they claimed net asset –virtually debt-free, by the way–was 180 Swedish krona. Today, you can buy all the stock you want at $97. Over the years, they have grown that NAV by double digits, on average, each year. They own engineering and power company ABB, Swedish appliance maker Electrolux, and they are big in the medical sciences, including 11% of AstraZeneca.

Henderson Land

Henderson Land is our largest holding. It is the biggest land bank in Hong Kong, and it has a lot of office buildings. They have a huge presence in mainland China.They also control Hong Kong & China Gas and Miramar Hotels. Henderson has an NAV of 57 in Hong Kong dollars, but you can buy all the shares you want at 27 Hong Kong dollars today. The company also has American Depositary Shares (ADS) symbol HLDCY. NAV in real estate means a lot in for international accounting, because unlike GAAP, income-producing real estate is carried at NAV, not at depreciated historic cost as it is here. The reported NAV is 57; we think it is well over 60. Stock sells for 27.

What about fixed income or preferreds?

Wow, what a time! Remember, my background is the distressed business–and there are now fantastic opportunities. I have pretty much determined that MBIA surplus notes and GMAC senior unsecured debt are going to be performing loans. We have bought the MBIA surplus notes at a 40% yield to call and 28% current yield. We bought GMAC's at a 55% yield to maturity. That is unbelievable.

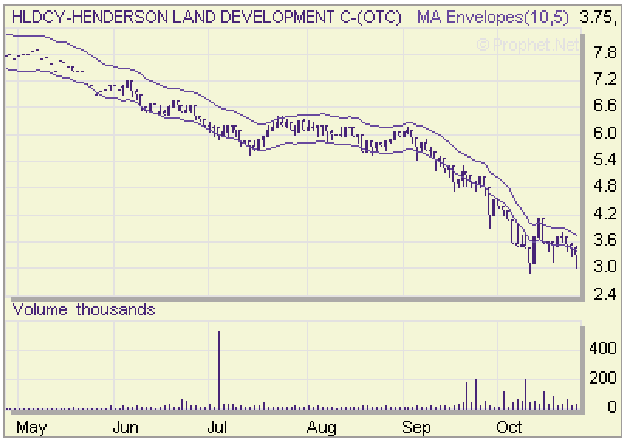
So suppose I am wrong and it is not a performing loan–I become one of the largest shareholders of a well-capitalized insurance company after it's restructured. Or a very well-capitalized finance company. I think this is very unlikely, but how can I go wrong with these? We also own MBIA stock because we expect a turnaround.

What about redemptions for Third Avenue Value Fund? How are you dealing with them?

Our fund is down year-to-date, so we have been getting swamped by redemptions, but we haven't really sold any of our core holdings, like the ones I mentioned before. We like to keep about 10% in cash, but [because of redemptions] we are at about 6% cash today.

Unfortunately, the public always redeems when it should be buying and buys when it should be redeeming. The way we look at it is asset management is first and foremost a function of liability management. If you are an individual or a pension plan, and you don't have to lay out cash for years to come, I think we are probably going to get 30% or 40% IRRs [internal rates of return] on these positions.

In Pictures: Marty Whitman's Top 10 Buys



Whitman Recommends: Henderson Land Development

Property development firm focused primarily on the Hong Kong market.

Market cap: $7.2 billion

Recent price: $3.70

52-week high: $10.04

52-week low: $3.09

P/E (price-to-earnings ratio): 3.8

Whitman Recommends: Cheung Kong

One of the largest Hong Kong developers of residential, commercial and industrial properties; flagship of Hong Kong's richest man, Li Ka-shing.

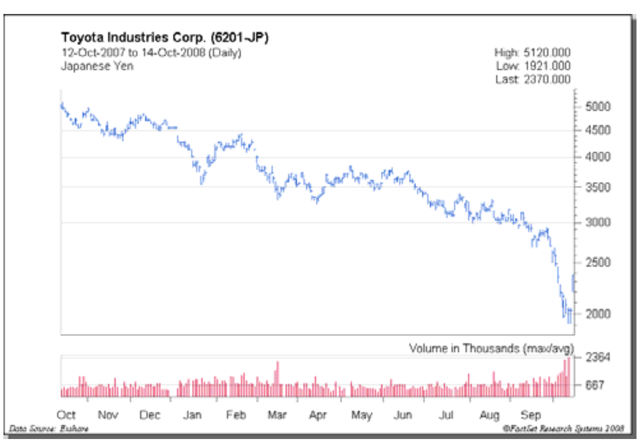
Market cap: $23.7 billion

Recent price: $10.25

52-week high: $20

52-week low: $9

P/E: 8.7



Whitman Recommends: Toyota Industries (TYO: 6201)

Owns stake in Toyota Motor and is also involved in industrial vehicles, logistics, textiles and electronic components.

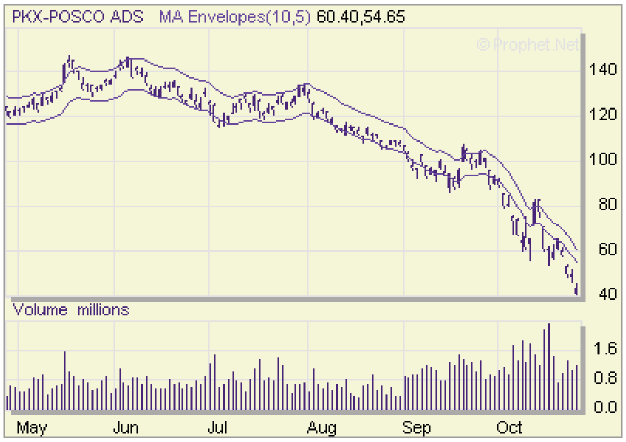
Market cap: $7.55 billion

Recent price: $23.18

52-week high: $43.72

52-week low: $19.26

P/E: 10.4



Whitman Recommends: POSCO

Largest steel producer in Korea.

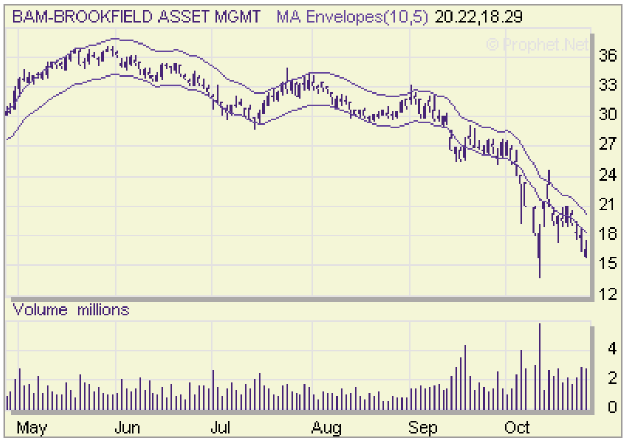
Market cap: $26.59 billion

Recent price: $76.11

52-week high: $190

52-week low: $55

P/E: 7.1



Whitman Recommends: Brookfield Asset Management

Global asset management company, focused on property, power and infrastructure assets.

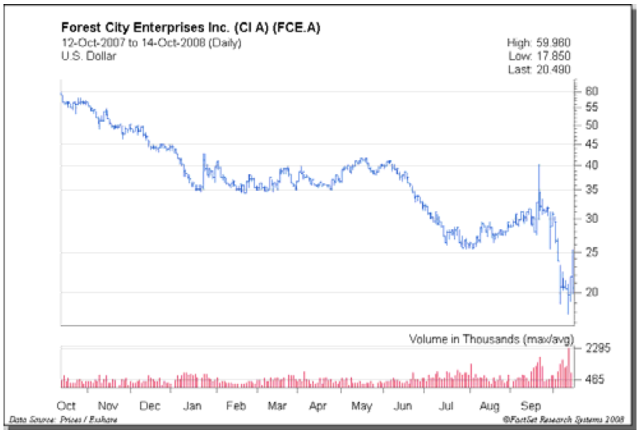
Market cap: $12.65 billion

Recent price: $21.67

52-week high: $40

52-week low: $14

P/E: 18.1



Whitman Recommends: Forest City Enterprises (nyse: FCE-A)

Real estate company engaged in the ownership, development, acquisition and management of commercial and residential real estate throughout the U.S.

Market cap: $2.14 billion

Recent price: $20.72

52-week high: $60

52-week low: $18

P/E: N/A

Whitman Recommends:
Wheelock Properties Limited (HKG: 0049)

Principal activities include property development, sales, marketing and asset management functions of Wheelock and Wharf Group properties in Hong Kong and China.

Market cap: $845 million

Recent price: 41 cents

52-week high: $1.19

52-week low: 41 cents

P/E: 7.3

Whitman Recommends:
Investor AB (STO: INVE B)

Private-equity-like holding company controlled by Sweden's Wallenberg family.

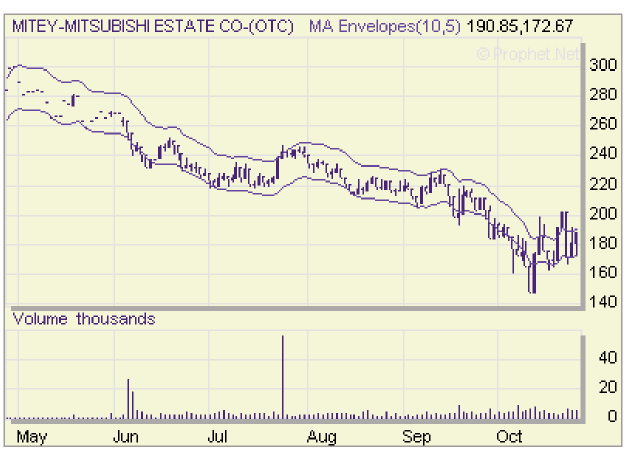
Market cap: $7.55 billion

Recent price: $16.58

52-week high: $27.65

52-week low: $13.42

P/E: N/A



Whitman Recommends:
Mitsubishi Estate

Japanese real estate company.

Market cap: $26.26 billion

Recent Price: $174

52-week high: $304.75

52-week low: $162.91

P/E: 30.1

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Whitman Recommends:
Mitsui Fudosan (TYO:8801)

The company is chiefly involved in the leasing and sale of real estate, mostly in Japan.

Market cap: $16.12 billion

Recent price: $18.33

52-week high: $28.66

52-week low: $14.43

P/E: 23.1

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