ValueInvestor INSIGHT
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Working Capital

Hosking Partners' capital-cycle investing approach is maybe a bit less contrarian than it was when we last spoke with Django Davidson and Luke Bridgeman. Which is not to say the cycles they're betting on have fully run their course.

INVESTOR INSIGHT

Hosking Partners
Luke Bridgeman (*l*), Django Davidson (*r*)

Editor's Note: *When we last spoke to Luke Bridgeman and Django Davidson of Hosking Partners [VII, December 30, 2022], they argued their capital-cycle investment approach – targeting industries where declining capital investment and capital returns have constrained supply relative to demand – while not particularly in vogue, was set to become increasingly relevant. As Davidson put it: "The last dozen years or so have advantaged investment styles benefiting from low long-term interest rates, low inflation, abundant liquidity and an ever more efficient global supply chain," he said. "We do think the tide has turned on a number of fronts."*

While investors' infatuation with the Magnificent 7 has not notably receded, Hosking Partners' relative focus in its $7 billion (assets) global strategy on opportunities in less-sexy market sectors has since then proven to be well-founded and profitable. We spoke with Bridgeman and Davidson recently for an update on where their capital-cycle analysis is directing them today toward mispriced value.

When we last spoke we discussed a number of areas – including mining, shipping, refining, and oil and gas – that had caught your interest much more than the market's. That disconnect has resolved somewhat in the interim – is your capital-cycle investing approach now pointing you elsewhere?

Django Davidson: One aspect of capital-cycle investing is trying to recognize in asset-heavy industries where assets built with old money and old financing terms are very valuable with new money and new financing terms. There hasn't been a large-scale U.S. oil refinery built for 50 years and with today's supply and demand dynamics if you own a refinery there that's a valuable asset to own. The replacement cost is very high and the return on capital required to get you over the line to build one is also very high indeed.

The returns have risen in all the areas you mentioned, but what we would need to see for new capacity to come in is a long period of sustained high returns. One or two or three years isn't going to be enough for someone to say, "I'm going to spend $5 billion on a new Gulf Coast refinery" or "I'm going to order 10% new capacity for the world's tanker fleet."

In these areas you also run into hurdles in terms of financing, permitting and sourcing. So the returns have to be high, you have to raise the money, you have to get approval to build your new mine or refinery, and then you may have to get in line to get that giant drilling rig or tanker ship built. It can take a time for supply to adjust, up or down, and we generally don't believe the supply response in most of these areas is near where it will need to be for our investment cases to go away.

The war in Iran is a new development since we last spoke. How has it impacted your investment cases in related areas?

Luke Bridgeman: Our overweight to energy has mostly been counter-consensus since it emerged six years ago. Prior to the Middle East conflict, the conventional view had been not only that the energy sector's cyclically low returns would never recover, but also that demand for fossil fuels was approaching a cliff edge. A longer-term view – however uncomfortable in light of current events – is that economic growth has throughout history been at least correlated with, if not caused by, an increase in energy consumption. Energy policy for much of the 21st century has promoted "green" technologies to disrupt this historical GDP/energy relationship, but the current crisis highlights that fossil fuels remain an essential source for the world's energy needs.

Since the start of the Iran conflict our energy exposure – 12% or so of the portfolio when the war began – has been an offset to weakness elsewhere as prices of energy-related commodities responded to the damage to Persian Gulf production facilities and the ending of free transport passage through the Strait of Hormuz. That's been positive for share prices in oil and gas producers, in energy-services firms like Noble Corp. [NE] and Tidewater [TDW], and in crude and product shipping companies such as Hafnia [Oslo: HAFNI] and International Seaways [INSW].

How has that impacted our investment cases? As capital-cycle investors we stay focused on supply rather than demand. In shipping, for example, you have visibility into the future because you can see the order books at the shipyards, you can measure the tonnage to be delivered in the next few years, and you can have a decent sense of the existing tonnage that will need to be scrapped going forward.

In the dry-bulk and tanker shippers to which we're most exposed, 10-20% of the total fleet will be delivered in new capacity over the next few years, but because of the capital diet in the industry the existing fleets have aged and we expect the scrapping of old capacity for some time to exceed the capacity added. That sets up well from a supply standpoint. That is less the case for liquefied-natural-gas carriers and more general containerships, where we don't have exposure. Shipyards are full of containerships and LNG carriers because they are the most complex and highly valued. There we're less confident in the supply/demand dynamics going forward.

A related area where we added to our holdings earlier this year is in refinery names such as Valero Energy [VLO], Phillips 66 [PSX] and Marathon Petroleum [MPC]. Because of the long-term under-earning of the industry, returns have to rise in order for capital to come in. Also because of the low returns, valuations were often more than 50% below the replacement cost of the assets. That's an interesting setup from a capital-cycle perspective against the efforts of the Trump administration to support U.S. energy dominance.

If you buy old-fashioned assets at less than replacement cost, the balance sheet is sound and there's a margin of safety in valuation, you're not paying anything for the optionality from exposure to the underlying commodity. In this case there were catalysts that made us more confident that the low returns were going to move higher. And then things happen like the war that can create volatility in the underlying commodity which you can benefit from without having paid for it.

Metals and mining have attracted more investor interest in recent years. Is this area as interesting to you as it once was?

DD: There is a big-picture capital-cycle point to make about the mining sector. The capital cycle in mining and metals is of course driven by industry returns – which generally have significantly improved – but capital flows are also impacted by equity valuations. High valuations attract capital and low valuations repel capital.

The mining sector is still a tiny proportion of the S&P 500, maybe 1.6% of the index vs. close to 50% for software, AI and the Mag 7. It's a tiny player in the passive indices, which continues to create some terrific opportunities because these companies are fundamental to our economic prosperity but aren't a big draw on people's financial or intellectual attention.

ON METALS AND MINING:

We have recycled capital from some areas to others, but our underlying belief in the opportunity here is still high.

When we spoke about platinum-group metals [*VII*, January 31, 2025] we made the case that platinum miners were trading at a fraction of the replacement cost of their smelting assets, forget the commodity assets in the ground. That's adjusted somewhat, but the market caps of these companies [Anglo American Platinum, Impala Platinum, Northan Platinum, Sibanye-Stillwater and Silvania Platinum] are still very low relative to asset values.

As an example, the enterprise value of Sibanye-Stillwater [SBSW] today is about $9 billion. In 2008, Xstrata (now part of Glencore) offered to buy the platinum producer Lonmin for $10 billion. Sibanye-Stillwater bought Lonmin in 2019, and it now makes up about 10% of the company's assets. The point is that valuations at the peaks of these cycles are high. We don't believe we're near those levels of excess and that the cycles in supply-constrained commodities like platinum-group metals and others are going to be very long.

I'd add that some of these commodities are being sucked into AI-related hype, as the metal intensity of AI is extraordinary. For every megawatt of AI compute capacity built, you need about 50 to 60 metric tons of metal. We have recycled capital within our mining basket – which makes up about 12% of the portfolio – from areas in which AI-thematic investors have gotten most involved into less highly valued areas. But our underlying belief in the capital-cycle opportunity in metals and mining is still high.

Speaking of AI, describe your current take on your portfolio holdings in semiconductor manufacturers.

LB: We've been long-standing investors in the memory-semiconductor space on the basis that the industry has seen continuous consolidation as companies unable to earn their cost of capital have gone bankrupt or sold out. Some 30 DRAM [Dynamic Random Access Memory] companies got down to three – SK Hynix [Seoul: 000660], Micron Technology [MU] and Samsung Electronics [Seoul: 005930] – and while the industry remains cyclical, the highs are higher and the lows are higher as well. We've tried to take profits at cyclical highs and reinvest at cyclical lows.

Then AI came along and things went crazy. With tremendous demand for high-bandwidth memory, the industry dynamics have improved dramatically. The three companies have largely maintained capex discipline as demand has gone through the roof, resulting in very strong returns.

Are you still enthusiastic about their prospects or have you been taking profits?

LB: The answer is yes to both. We have been taking profits but we're also humble enough to recognize that we don't know how long this will last. Ultimately the cure for high prices is high prices, so at some point things will correct. But that doesn't mean the current state of affairs can't go on for some time, so we still retain significant exposure to the memory companies.

Are there any new areas that have attracted your attention recently as capital-cycle investors?

DD: The big change since we spoke in 2022 is that we've moved from basically nothing to 13% of the portfolio in Japan. I'd frame this as a country-level capital cycle. Capital-cycle analysis is driven by returns on capital, and that usually focuses on the numerator, or how much profit a company is going to make. In Japan the denominator is shrinking as companies reduce cross-holdings, unwind stakes in competitors, sell off long-held real estate and, in an increasing number of cases, return capital to shareholders through dividends and share repurchases.

That really is a sea change. Companies whose businesses are relatively stable are increasing returns on capital and "shrinking to greatness." The runway for this is long, not least because there are over 6,000 listed Japanese firms. We have built a basket of 70 or so companies – mostly in small and mid caps – that are predominantly improving returns by shrinking their balance sheets. As returns on capital rise, share prices often follow.

Can you give us a good representative example from that 70-strong list?

DD: One would be Hikari Tsushin [Tokyo: 9435]. Its operating business is essentially reselling through a 20,000-strong direct sales force things like telecom and IT services, utilities and even insurance, but it also has a very large – and leveraged, with long-term 0%-interest loans – investment portfolio. The founder is a disciple of Warren Buffett and the company now owns shares in close to 600 public stocks, most of which are small, difficult for investors like us to own, and trade at very attractive valuations. They see the same opportunity we do and if you believe in this country-level cycle of improving corporate governance, improving returns and improving valuations, we believe this is a smart way to play it. [*Note*: At a recent price of ¥36,550, Hikari Tsushin shares trade at 14.2x estimated forward earnings and at 1.4x reported tangible book value.]

Returning to mining, describe your case today for Altius Minerals [Toronto: ALS].

LB: This company doesn't fit neatly into a specific category, making it more likely to be underfollowed and mispriced. In exchange for land-development rights or upfront or early-stage capital, it collects royalty streams on the revenue eventually generated across a broad range of metals, materials and renewable-energy projects. The portfolio is seasoned across time and geography and today has diversified exposure to copper, lithium, nickel, potash, iron ore, gold, solar energy and wind energy.

With royalty claims on revenue, rather than having an equity interest where you share in the profits you earn your money based on the top line and are not exposed to the costs of the business. In an inflationary world, if the costs of digging things out of the ground go up, not only do you not suffer from that, you also will likely benefit because the price of the commodity will increase as well. Altius's royalties typically stem from a registrable interest in the land where the project is developed, making it difficult to dilute the position by ownership changes in the project itself.

Altius is unique in that a number of its projects are initially found and conceived by its own active project-generation team. It will stake interests in land with the po-

INVESTMENT SNAPSHOT

Altius Minerals
(Toronto: ALS)

Business: Develops, acquires and manages a portfolio of project royalty interests in areas including copper, lithium, nickel, potash, iron ore, gold, solar energy and wind energy.

Share Information
(@5/29/26, Exchange Rate: $1 = C$1.38):

Price	**C$57.92**
52-Week Range	C$26.13 – C$58.07
Dividend Yield	0.7%
Market Cap	C$3.23 billion

Financials (TTM):

Revenue	C$63.3 million
Operating Profit Margin	40.5%
Net Profit Margin	n/a

Valuation Metrics
(@5/29/26):

	ALS	S&P 500
P/E (TTM)	9.4	25.7
Forward P/E (Est.)	n/a	22.4

Largest Institutional Owners
(@3/31/26 or latest filing):

Company	% Owned
Hamblin Watsa Inv	8.4%
Waratah Capital Adv	6.7%
Fidelity Mgmt & Research	4.9%
EdgePoint Inv	4.5%
Mirae Asset Global Inv	3.8%

Short Interest (as of 5/15/26):

Shares Short/Float	n/a

ALS PRICE HISTORY

THE BOTTOM LINE

Co-founder and CEO Brian Dalton has demonstrated clear ability as a countercyclical investor in metals and mining royalty assets since the company listed it shares publicly in 1997, says Luke Bridgeman. If it meets its goal of more than doubling annual revenues by 2030, Bridgeman could imagine shareholder returns compounding at a similar rate.

Sources: S&P Capital IQ, company reports, other publicly available information tential for a mine and then bring in operators to own equity in the project and bring it to production while Altius retains a royalty interest.

We imagine management acumen is an important part of your investment case here.

LB: Brian Dalton co-founded the company in his dormitory room at Memorial University of Newfoundland in the 1990s and remains the CEO of a firm that still has less than 20 employees. Since the share listing in 1997 the stock price has compounded at more than 20% per year and he has demonstrated clear ability as a countercyclical investor in royalty assets over time. The exposure is diversified but regularly changing, more recently in exiting coal and uranium and investing more capital in renewables and electric-battery exposed lithium. We have a positive general view on mining and metals and Brian is a proven capital allocator we trust to help navigate the cycles for us in these areas.

Tell us more about the renewable-energy exposure.

LB: I mentioned that royalties are generally tied to an interest in land. For wind or solar projects, Altius provides development funding to get them to the point where permits and contracts are in place to enable project financing to be raised. When they're up and running Altius earns a royalty on the revenues generated.

The company today earns royalties on power-generation projects producing 2.9 gigawatts of electricity per year, with another 1.7 gigawatts of capacity under construction and 14 gigawatts in the development stage. For a time this part of the business traded separately as Altius Renewable Royalties, but it was taken private 18 months ago with a private-equity partner and Altius retains a 57% stake.

How are you looking at valuation from today's C$58 share price?

LB: Given the pipeline of in-development royalty assets, the company expects revenues to more than double from C$90 million this year to around C$200 million by 2030. If that happens, it's not unreasonable to expect that net asset value would more than double as well. If the stock then trades at even the current level of 1.5x net asset value – below where metals-streaming firms commonly trade – that would provide a very nice return on the shares.

We're probably more excited about the potential beyond that. There are so many projects at various stages of maturity that there is a considerable amount of embedded upside optionality. It may not always be a smooth ride, but we believe this can be a very interesting long-term compounder of value.

For something completely different, explain why you're so high on the investment prospects for eclectic U.K. consumer-services firm Saga Plc [London: SAGA].

DD: Our unconstrained approach allows us to own meaningful stakes in idiosyncratic "risky" opportunities where we think there is multi-bagger upside. As Bill Miller said, "If you don't look for multi-baggers, you certainly won't find them!" Having multiple managers with individual

INVESTMENT SNAPSHOT

Saga Plc
(London: SAGA)

Business: U.K.-based provider of travel-holiday packages and a range of insurance and financial-services products targeting the 55- to 75-year-old age demographic.

Share Information
(@5/29/26, Exchange Rate: $1 = £0.74):

Price	**£5.78**
52-Week Range	£1.41 – £6.53
Dividend Yield	0.0%
Market Cap	£842.1 million

Financials (TTM):

Revenue	£666.1 million
Operating Profit Margin	15.7%
Net Profit Margin	0.5%

Valuation Metrics
(@5/29/26):

	SAGA	S&P 500
P/E (TTM)	206.4	25.7
Forward P/E (Est.)	15.0	22.4

Largest Institutional Owners
(@3/31/26 or latest filing):

Company	% Owned
Hosking Partners	7.1%
Hargreaves Lansdown	4.7%
Aberdeen Group	4.2%
Schroder Inv Mgmt	2.7%
Union Bancaire Privee	2.4%

Short Interest (as of 5/15/26):

Shares Short/Float	n/a

SAGA PRICE HISTORY

THE BOTTOM LINE

After being sidetracked by a long period of private-equity ownership, Django Davidson believes the company is now well into a turnaround as it again delivers on its promise to be the most trusted brand for people over 50 in the U.K. While the shares are up 4.5x over the past two years, he thinks they "could still do another 4.5x" in the next five years.

Sources: S&P Capital IQ, company reports, other publicly available information responsibility for their own parts of the portfolio also means we can scale into positions as more PMs build conviction. Saga is a good example on both fronts that over five years has grown from a 20-basis-point position to our fifth-largest holding. We own more than 7% of the outstanding shares.

The company has a colorful history. It was founded in 1951 by Sidney de Haan and in its early days mostly offered retired people high-touch, low-cost, out-of-season coach holidays, mainly to seaside towns in the U.K. Over time the customer offering has evolved and grown, driven by a powerful direct-to-consumer marketing engine and a core philosophy that the current Chairman, Sir Roger De Haan, describes as "taking good care of older people." The primary business remains travel, through ocean and river cruise ships engineered for older travelers, but other verticals include low-cost insurance products – for travel, motor, home and health – and financial-services products tailored to aging borrowers and savers.

Every good story has its villains, and in this case there was a long period of private-equity ownership that tested the resilience of the Saga brand. The De Haan family exited the business in 2004, and the company then passed through various private-equity owners with predictable consequences: Inappropriate leverage via dividend "recaps," short-term profit maximizing, customer neglect and then an IPO in 2014, after which the shares fell 95% over the next five years.

The dire business performance and IPO disaster had one positive outcome. It prompted the return to Saga of Roger de Haan, the son of the company founder. In late 2020 he invested £100 million in an equity rights issue and lent another £80 million to the company to help shore up its balance sheet. He then took the Chairman role and now owns close to 30% of the outstanding shares.

We're more than five years into a turnaround that has streamlined and focused the company, most prominently by exiting a capital-intensive insurance underwriting business. The balance sheet has been improved – net debt to EBITDA has gone from 10x to around 4x – and further debt reduction remains a priority. Most importantly, in all aspects of the business the company is again putting the customer first and working to deliver on the brand promise "to be the most trusted brand for people over 50 in the U.K." We're past most of the ugly reorganization-related writedowns and charges, so now expect the turnaround in the business to be more clearly reflected in the financials.

ON MANAGING RISK:

One response for us to systematic risk is to hold a highly diversified portfolio, with holdings often in thematic baskets.

What are the potential drivers of growth here?

DD: The cruise business is the main driver and we think currently serves only a small percentage of its ultimate potential customers. Saga now owns two cruise ships and takes about 35,000 people on holiday a year. But there are six million people in their target demographic of 55- to 75-year-olds in the U.K., who have become wealthier and continue to spend more per capita on travel and experiences. To meet demand the company will eventually have to buy more ships, which we expect to happen in the next year or two after the debt is further paid down.

There's also a demographic tailwind behind the insurance-brokerage and personal-finance businesses. Here we think the brand trust and recognition – which surprisingly has survived the years of company mismanagement – is critical. Older demographics demand and need tailored products and services in these areas and obviously put a high premium on trust in choosing with whom they do business. We believe Saga's brand positions it well to continue to expand and deepen its relationships with its customers.

The stock over the past two years is up almost 4.5x. Now at around £5.80, how are you looking at upside from here?

DD: It could still do another 4.5x. In our full-steam-ahead scenario for Saga we believe it can generate circa £220 million of annual operating profit in the next five years or so. As a sense check, that's only slightly above what it was earning in the late 2010s, although then with a good-sized insurance underwriting operation. At £220 million in EBIT, it would be generating 20% returns on invested capital and growing revenues at GDP-plus, which for a capital-light, cash-generative business could easily justify an EV/EBIT multiple in the high teens. That would translate into a stock price of around £25 per share.

There's asset value behind the current share price. The replacement cost for Saga's two cruise ships, now close to £1 billion, has dramatically increased since it purchased them. With the total company enterprise value around £1.2 billion, you're only paying £200 million for the operating business – less than we think over the medium term it can earn in annual operating profit.

Are there market scenarios you can imagine that could turn the tide against your capital-cycle approach?

LB: In the short to medium term the answer is always yes, even if we don't know exactly what they might be. While we think it is highly unlikely, we could go back to a period of super-low interest rates, low inflation, high levels of liquidity and increasing globalization that was somewhat of a headwind for us after the financial crisis.

One of our main responses to systemic risk is to hold a highly diversified portfolio with 350 to 400 names, often held in thematic baskets of stocks. In a universe of 40,000 listed companies, we would submit that diversified portfolios can look very different from the index, which means the outcomes can also be very different from the index returns. We'd argue our approach reduces exposure to crowded trades, against years of momentum-making passive strategies increasingly concentrating in large companies. We also believe a diversified portfolio allows more room for taking idiosyncratic risk in individual stocks, provided the price is sufficiently attractive to compensate. Non-correlated idiosyncratic risk in a diversified portfolio should contribute to returns.

As markets evolve, we think as a diversified manager we can adjust our portfolio across categories more dynamically than a concentrated manager can. Capital cycles don't move at the same time in the same way. If a tide, as you say, moves against us in one area, there are usually others where we see it creating an opportunity. VII