

Manager's Commentary

Aman Budhwar, CFA

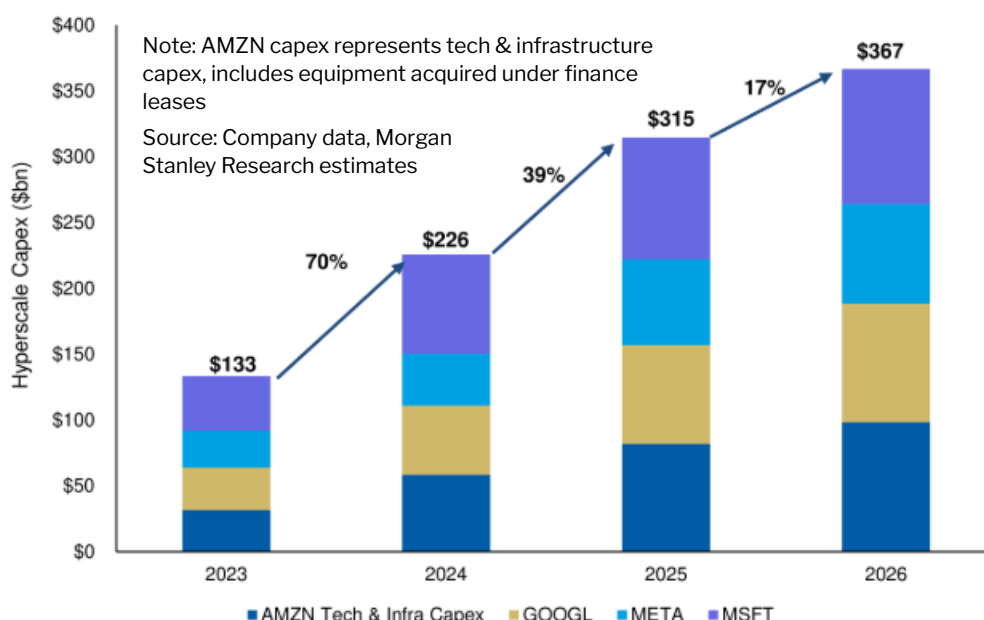
The S&P MidCap 400 Index posted total returns of 3.85% for January 2025, outperforming its large cap peer S&P 500 Index by 107 bps. At the end of January 2025, the S&P MidCap 400 index was trading at projected price / earnings multiple of 16.8x, a 5.6x discount to the S&P 500 Index while offering a cash flow yield of 5.2% vs 3.08% for the S&P 500 Index¹.

Hyperscaler capex ramping up to the benefit of small/mid cap companies

Artificial Intelligence (AI) is quickly becoming an integral part of conversations companies are having as they seek to boost productivity and build processes to be able to better respond to their clients' needs.

With rising compute demand, recent guidance on 2025 capital investment plans from the likes of Amazon, Google and Meta put to rest any doubts on the need for scaling up AI infrastructure investment that may have crept in after the revelation from a Chinese AI startup DeepSeek which claims to have made technical breakthroughs that allow for the training of advanced AI models at a fraction of the computing costs required by US competitors..

This is particularly beneficial for many US small and mid-cap companies that serve this growing market opportunity, including several of our portfolio companies.



Notable Portfolio Developments

- Genpact Ltd. (NYSE: G) is a global professional services and solutions firm serving leading enterprises based on its deep business and industry knowledge, digital operations services and

¹ S&P MidCap 400 and S&P 500 Indices

expertise in data, technology and AI. They reported better than expected results for the quarter ended December 2024 led by double digit growth in Data-Tech-AI which saw the fourth quarter in a row of accelerating growth². Profit margins also exceeded expectations. Genpact announced the availability of the first in a series of agentic solutions that leverage GenAI and machine-learning models to automate tasks driving superior value for clients. It also launched Gigafactory, a first-of-its-kind AI accelerator, designed to help enterprises rapidly scale AI solutions from pilot to full-scale production. Management believes GenAI is significantly expanding their total addressable market, and they are well positioned to make the most of this opportunity.

- Webster Financial Corporation (NYSE: WBS) offers a range of financial services to individuals, families and businesses in the US. Results for the December 2024 quarter were better than expected with attractive margins, solid fee income and expense control. Net interest income on a like-for-like basis increased 7.4% YoY helped by loan growth of 3.5%. Non-interest income increased 36% YoY and returns on average tangible common equity (annualized) was 17.7%³. We believe Webster is well positioned to drive double digit earnings growth as it benefits from a diversified deposit base and strong capital levels that should help it grow its balance sheet while maintaining its net interest margins.
- Harmonic Inc. (Nasdaq: HLIT) is the global leader in broadband and video delivery solutions, enabling media companies and service providers to deliver ultra-high-quality video streaming and broadcast services. The shares have come under pressure due to delays in its customers' network upgrade plans. Customer concentration, with two of its largest customers accounting for almost 70% of sales, has also been a risk for the company. We trimmed our position in the stock ahead of year end results and are reevaluating our investment thesis in the company.
- Fluor Corporation (NYSE: FLR) provides engineering, procurement and construction, operation and maintenance, asset integrity and project management services worldwide. The stock has come under pressure after reporting an underwhelming third quarter in early November due to the cancellation / delay in recognizing revenue on certain projects. However, we believe the bidding environment remains positive and project work in data centers, pharmaceuticals, nuclear / environmental and mining amongst others will be key drivers for growth in the next few years. Management has derisked the business by doubling the share of reimbursable contracts in backlog from 40% in 2020 to 80% in 2024⁴. We expect profit margins to improve reflecting higher margin work in the backlog won over the last few years.

New Position

We initiated a position in Tidewater, Inc. (NYSE: TDW) during the month. Founded in 1956, Tidewater currently owns the largest and highest specification Offshore Support Vehicle (OSV) fleet in the industry supporting offshore energy exploration and production activities worldwide. The long-term outlook for the offshore market remains strong as over 90% of committed offshore capital investment totaling \$245 billion over the next two years has a break-even price of less than US\$60/billion (vs current forward Brent curve at >\$70/billion).

² Genpact Ltd. (G) Q4 2024 Earnings Call, Feb. 6, 2025

³ Earnings Conference Call Fourth Quarter 2024, Jan 17, 2025

⁴ <https://fluorenterprisesinc2023rbcr.q4web.com/news/news-details/2024/Fluor-Reports-Third-Quarter-2024-Results/default.aspx>



The market has been starved of new OSVs as average day rates during 2018-21 were not supportive of investment in additional capacity. Since hitting a bottom in 2021, Tidewater's average day rates have more than doubled to a high of US\$22,275/day in September 2024 and we believe there is more upside as leading-edge day rates for new contracts are almost 30% higher than current average day rates. Also, management believes new-build economics currently require a through cycle average day rate of \$44,000 to achieve net zero NPV based on a 20-year useful life⁵.

When it comes to cyclical commodity-oriented businesses, we look to invest at a time when capital has left the market and demand-supply dynamics are favorable, such that the remaining players are able to earn a positive economic return on their invested capital.

Outlook

Recent headlines around import tariffs and undocumented immigrants have caused anxiety in the markets, with the US consumer sentiment dipping to a seven-month low according to preliminary February data from the University of Michigan Surveys of Consumers. The survey also measured consumers' inflation expectations for this year which rose a full percentage point from 3.3% last month to 4.3%. We are taking a cautious approach and using short term volatility in the market to build positions in high quality compounders trading at reasonable valuations.

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February 14, 2025

⁵ Tidewater November 2024 Investor Presentation