MARCH 15, 2024

TAPASYA INVESTMENT FUND I

GLOBAL INVESTMENT REVIEW - VIII

INTRODUCTION

Welcome to the **8th edition** of the "**Global Investment Review**". This document aims to elaborate on the investment thesis of companies in which we have made investments.

The focus of this document will be

1) Howard Hughes (HHH)

2) Bubbles

This edition we will delve into **Howard Hughes Holding (HHH)** one of the leading developers of large-scale master-planned communities (MPCs) in the country.

I anticipate this company to be a long-term compounder, with the caveat that the results and returns will be concentrated in the later periods.

Additionally, I utilize this document to convey my thoughts on various facets of investing to my investors. In this edition, I will address the concept of "**Bubbles**."

We have all witnessed and heard about market bubbles, with the "Dotcom" bubble being the most commonly referenced in our lifetime. My aim is to tackle some key questions:

- What are the various categories of financial bubbles, like stock-specific, sectoral, and so on?

- What are their essential characteristics?

- Most importantly, what can or should be done to address them?

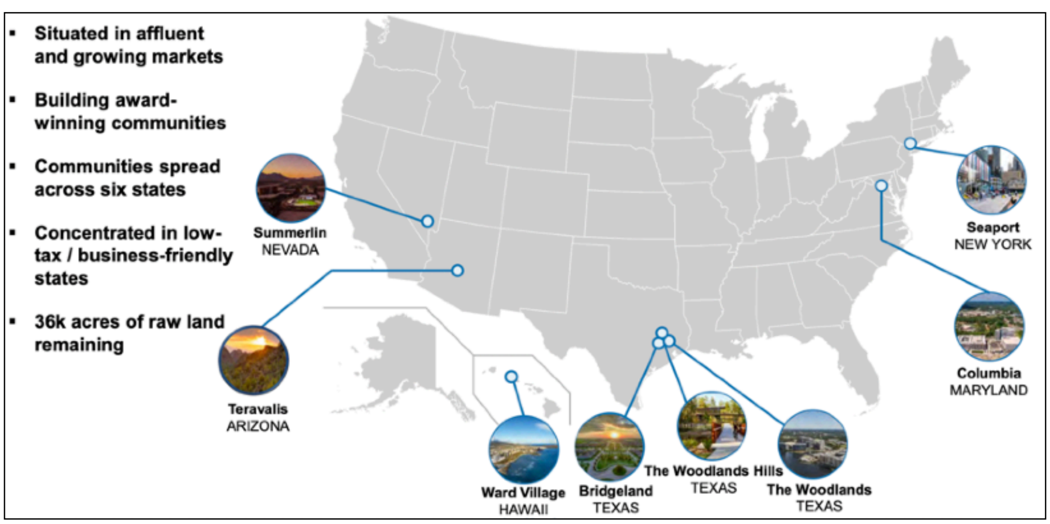
HOWARD HUGHES HOLDING (HHH)

Howard Hughes Holdings Inc. owns, manages, and develops commercial, residential, and mixed-use properties in the United States. It operates through four segments:

- **Master Planned Communities (MPCs)**: These are large-scale, mixed-use communities planned and developed by the company. They typically include residential areas, commercial spaces, and recreational facilities.
- **Operating Assets**: This segment consists of income-generating properties like retail stores, office buildings, and multi-family residential units, primarily located within the MPCs.
- **Seaport District**: This segment comprises a multi-block district under private management in New York City, featuring various commercial properties and attractions.
- **Strategic Developments**: This segment focuses on developing and managing standalone commercial properties outside of the MPCs.

HHH Portfolio at a glance

6.8M SF Office	2.6M SF Retail	5,587 Units Multi-Family	2,670 Units Condos Closed
8 Communities	36k Acres Raw Land	9% Historical YOC	21% Historical ROE



Source: HHH 2023 Investor Deck

How do they make money

Howard Hughes Corporation generates revenue through various channels across its business segments:

- **Land Sales**: The company sells land parcels within its MPCs to builders for residential and commercial development.

- **Rentals**: They earn rental income from commercial properties like office buildings and retail stores, primarily located within the MPCs. They also get rental income from multi-family residential units.

- **Property Management**: Howard Hughes Corporation provides property management services for third-party owners within some of their MPCs, generating fee income.

I will employ a somewhat distinct methodology in elucidating this business, particularly with respect to valuation. The rationale for this approach is as follows:

- Traditional GAAP accounting inadequately captures the economic underpinnings of such enterprises

- Short-term cash flows fail to reflect the long-term economic prospects of the business.

- The book value of assets does not accurately reflect their fair value.

Certain fundamental issues that real estate and land development businesses must contend with include:

- Their highly capital-intensive nature.
- The numerous zoning requirements and approvals that are necessary.
- Their susceptibility to market fluctuations (interest rates, economic cycles, etc.), which is even more pronounced when compared to other businesses.

In the context of such businesses, notably in the instance of Howard Hughes, a concentration of profits towards the terminal stages, such as the sale or development of the final lots, is observed.

Furthermore, pricing is significantly influenced by supply and demand. I shall illustrate this with an example. Because these developments are highly location-specific, if builders identify a demand gap of 100 units, it is highly probable that they will strive to meet that demand by, for instance, constructing 25 units. Meeting this demand requires a long lead time from land acquisition to construction completion. At the same time, other builders/ developers may follow suit; let's say four other developers do the same. This would result in the creation of 125 units to meet the demand for 100 units. To further complicate matters, given the timelines from land acquisition to construction, economic cycles, and interest rates may be at a different stage than when the demand was initially identified, potentially leading to further complications.

Subsequent to an extensive examination of the challenges confronting such enterprises, one might justifiably inquire as to why an investment in Howard Hughes would be deemed prudent.

So here it goes, my explanation.

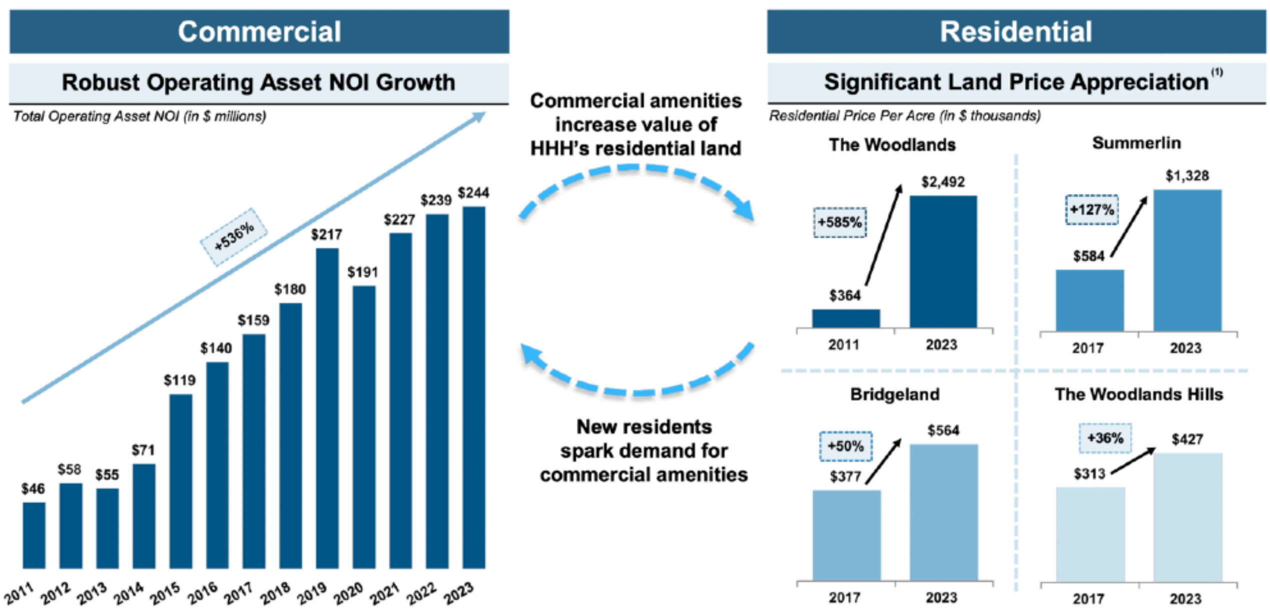
Firstly, as you may have heard, in the realm of real estate, it is often emphasized that “Location, Location, Location” is of paramount importance. HHC is fortunate to possess some of the most distinguished award-winning properties situated in states that are characterized by low taxes and a business-friendly environment. Additionally, these properties are located in affluent neighborhoods.

HHC owns approximately 100,000 gross acres of land. It exercises complete control over the quantity of land sold during each fiscal quarter or calendar year, thereby influencing the demand and supply dynamics discussed earlier.

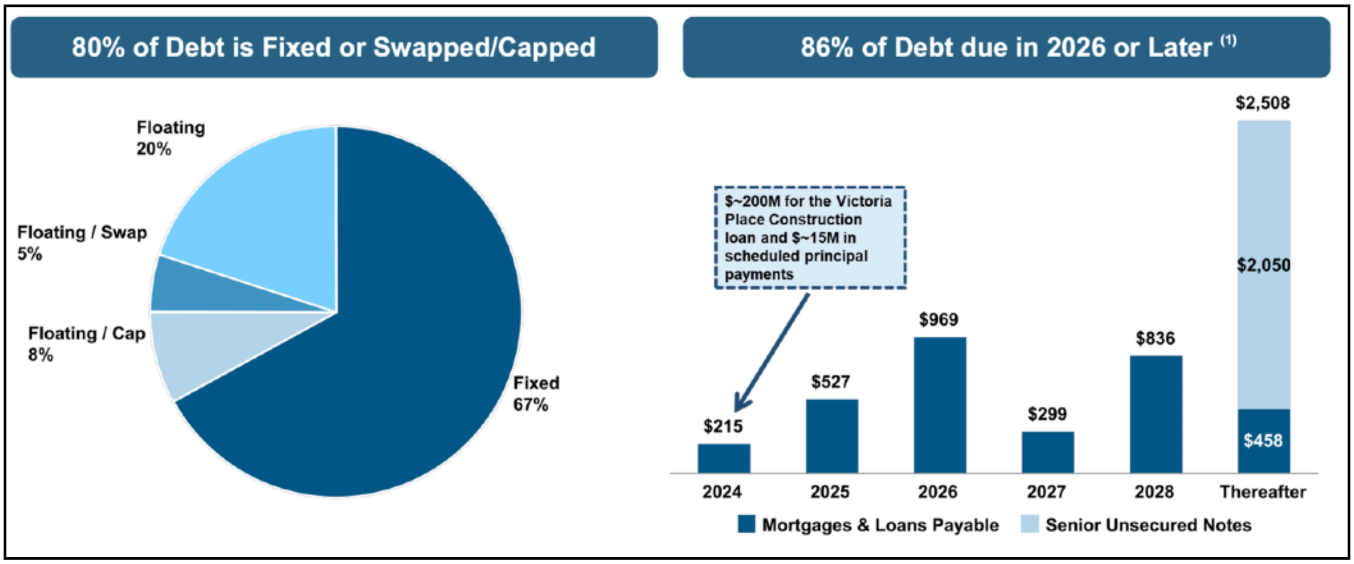
Moreover, as the company continues to sell land, the appreciation in the value of the remaining land compensates for the reduction in the land inventory. For instance, Summerlin in Nevada and Woodland Hills in Houston have experienced an 11% compound annual growth rate (CAGR) since 2011, while Bridgeland in Houston has demonstrated a 7% CAGR.

Cashflows could be lumpy due to their dependence on various supply demand factors and economic cycles, as previously stated. Therefore, examining quarterly figures alone may not provide an accurate representation of the overall financial performance.

HHC has shown a robust track record in growing NOI (Net Operating Income)



Another significant aspect to assess in real estate investment is the financial stability of the entity, as reflected in the strength of the balance sheet, liquidity, and impending debt maturities. A substantial portion (80%) of the outstanding debt is fixed, swapped, or capped, providing a level of certainty in interest rate exposure. Additionally, a majority of the debt (86%) is not due until 2026 or later, ensuring a favorable debt maturity profile.

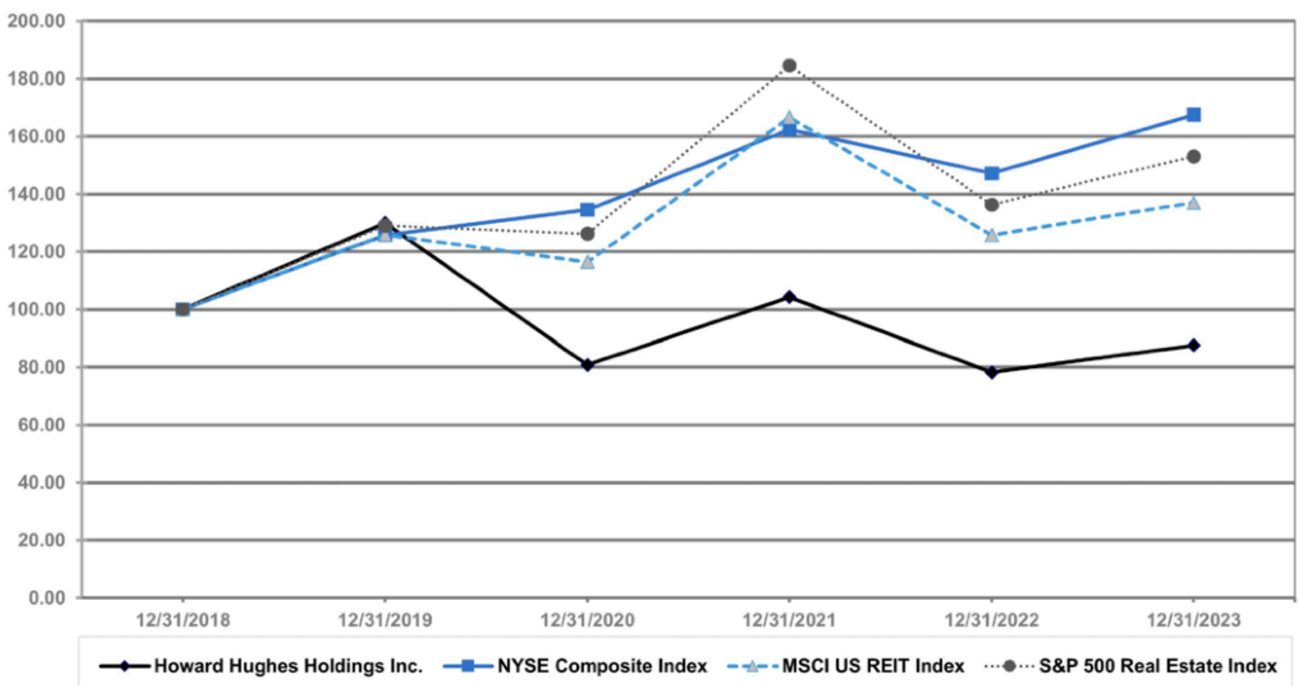


One factor that warrants consideration is that, historically, the company's stock price has underperformed its primary benchmarks over the past five years. I anticipate that this situation will undergo a reversal in mid-2024.

The prevailing interest rate environment suggests that conditions remain highly favorable for ‘New’ home sales. The supply of existing homes is constrained, as the majority of homeowners are locked into mortgage rates of 4% or lower and it is highly unlikely that mortgage rates will fall below 6% in 2024 or even 2025. This supply constraint is anticipated to serve as a catalyst for HHC's growth.

We have bought into this company with a very long term horizon. We could revisit this document in a couple of years to see whether the thesis does work out (or not)?

STOCK PERFORMANCE GRAPH



Risks

As mentioned previously this business is highly susceptible to several macro level risks.

These include

- Downturn in housing markets due to declining economic conditions
- Sales are sensitive to interest rates and consumers credit worthiness
- Downturn in tenants business can impact rental revenues and cashflows
- Consolidation or closing of anchor stores in malls at MPCs
- Potential Natural disasters

BUBBLES

Let me start with why I chose this topic “**Bubbles**”. The recent surge in Nvidia’s stock price, coupled with the subsequent rise of several related chip stocks such as AMD, ARM and even Intel prompted me to explore the characteristics of a bubble.

One of my primary motivations for delving into this topic was to ascertain whether it is possible to identify bubbles as they occur, thereby mitigating potential losses for myself and my investors. It is worth noting that the precise origin of the term "bubble" in the context of financial markets is uncertain, although it is believed to have been coined during the South Sea Bubble of 1711-1720, which will be discussed in greater detail later.

Financial Bubbles: A Formal Exploration

In the realm of finance, a "bubble" commonly refers to a rapid and often irrational surge in the price of an underlying asset, resulting in a significant divergence from its intrinsic value.

Throughout history, there have been a variety of bubbles, ranging from tangible assets like the Tulip Bubble (1634-1637) and the Real Estate Bubble (2003-2007) which led to the 2008 Great Financial Crisis, to industry-specific bubbles such as those in the CBD, Solar, and EV car sectors, to more comprehensive market-wide bubbles like the Dotcom Bubble (1995-2000), which was marked by a rapid increase in the value of internet-related stocks.

In the context of stocks, valuation should ideally be based on a rational projection of future cash flows. However, there are instances where stocks are valued akin to Rembrandt paintings, acquired solely because their prices have been on an upward trajectory.

Case Studies of Speculative Financial Bubbles

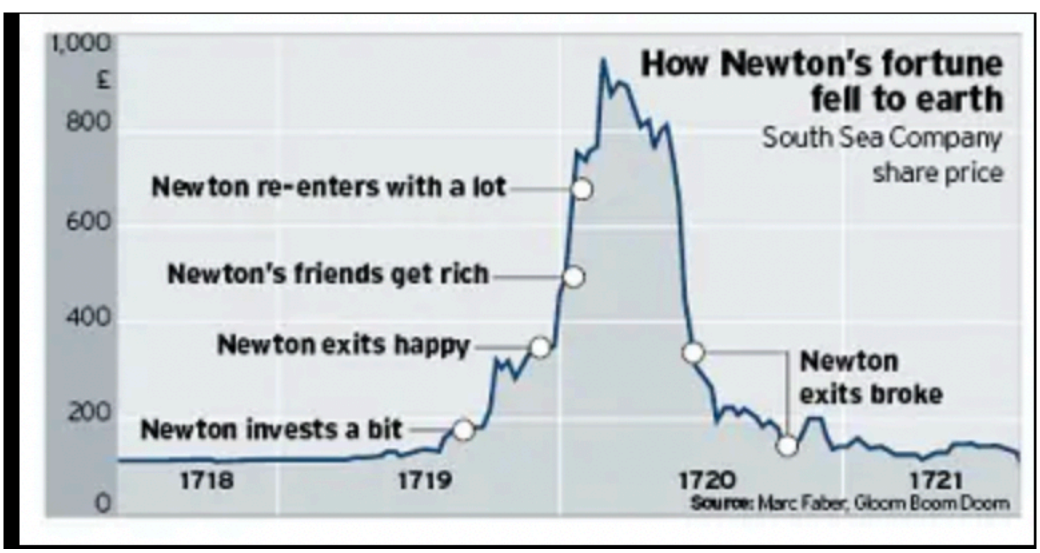
Tulip Bubble:

The *Tulip Bubble* is a prime example of a speculative asset price bubble, which occurred in the Netherlands in the 17th century. It began with the introduction of tulips as a luxury good, and specific varieties became a symbol of status and wealth. The availability of futures contracts without immediate delivery of the tulips fueled speculation and drove prices to unsustainable levels. The Netherlands, which was experiencing prosperity at the time, coupled with easy access to credit and funds, further contributed to the price increases. However, the bubble eventually burst, resulting in significant losses for many investors. Notably, there is no evidence of long-term damage to the economy as a result of this bubble.

South Sea Bubble:

The *South Sea Bubble* was an economic frenzy that took place in England in the early 18th century and involved rampant speculation in the shares of the South Sea Company. The bubble reached its peak in 1720 when the share price rose from £128 to approximately £1000 by August, only to plummet to £150 in September of the same year. The company had been granted exclusive trading rights in Spanish South America, but when the results failed to meet expectations, the company resorted to financial engineering, including a public debt scheme, to bolster its profits. Company leaders and shareholders engaged in aggressive promotion of future revenues, fueling a speculative frenzy. Public outcry following the disclosure of fraudulent activities led to the enactment of the Bubble Act of 1720, which required publicly traded companies to obtain a royal charter in an effort to prevent future bubbles and fraudulent practices.

It is said that renowned physicist Isaac Newton, known for his extraordinary intellect, was not immune to the allure of the South Sea Bubble. He allegedly remarked, "*I can calculate the motions of the heavenly bodies, but not the madness of people*."



In recent years, the **electric vehicle (EV) sector** has attracted significant attention. Some EV stocks have experienced notable declines from their all-time highs (ATHs), as indicated by a tweet from Charlie Billello on February 27th' 2024.

Company	Ticker	% Below High
Li Auto	LI	-25%
BYD	BYDDF	-44%
Tesla	TSLA	-53%
Xpeng	XPEV	-88%
Polestar	PSNY	-90%
NIO	NIO	-91%
Vinfast	VFS	-93%
GreenPower	GP	-94%
Rivian	RIVN	-94%
LionElectric	LEV	-95%
QuantamScape	QS	-95%
Lucid	LCID	-95%
Fisker	FSR	-98%
Nikola	NKLA	-99%
Canoo	GOEV	-99.4%
Lordstown	RIDEQ	-99.7%
Proterra	PRTAQ	-99.95%
Arrival	ARVLF	-99.95%
Faraday	FFIE	-99.99%

Essential Characteristics of a Bubble:

Irrational Exuberance: Investors demonstrate excessive optimism, disregarding potential risks, focusing on potential gains, and adopting a "get rich quick" mindset.

Liquidity: The presence of readily available capital or funds is closely associated with bubbles. While not the primary cause, bubbles rarely exist in the absence of deployable capital. Factors such as low-interest rate environments and increased liquidity resulting from actions such as quantitative easing contribute to this characteristic.

Media Hype: Positive media coverage during these times amplifies excitement and further inflates the bubble.

Herd Behavior: Social Proof influences individuals to follow the herd, engaging in actions simply because others have done so. The combination of Social Proof, Fear of Missing Out (FOMO), and the "Get Rich Quickly" mindset further inflates the bubble.

In conclusion, there is often a kernel of truth in financial bubbles, as evidenced by the Dotcom Bubble, electric vehicles, and semiconductors. The critical question for investors is whether to participate in investments that are significantly detached from their underlying value.

Even within the professional investment community, there are divergent views. Some investors, such as Warren Buffett, have a temperament that leads them to avoid bubbles, even at the cost of underperforming the market, as in the case of the Dotcom Bubble. In contrast, investors like George Soros believe in running towards a bubble to capitalize on the opportunity.

In the sphere of investing, it is of utmost importance for investors to possess a thorough comprehension of their psychological disposition, especially during periods characterized by the emergence of market bubbles. The ability to accurately forecast market movements and exit prior to the culmination of such bubbles is a rare attribute possessed by a select few individuals.

"Whenever you find yourself on the side of the majority, it is time to pause and reflect."
- Mark Twain

When should you pause and reflect

- When current valuations are based on overly optimistic future projections
- When irrational gains start to be extrapolated
- When envy arises towards neighbors or friends who have experienced significant market gains
- When media articles frequently highlight individuals who have achieved substantial wealth through market participation

The presence of bubbles is a persistent phenomenon that will remain an integral aspect of our societal fabric. From my perspective, with the advent of social media platforms, we have become increasingly susceptible to both the formation and partaking in financial bubbles. This dynamic was evident in the surge of meme stocks such as GameStop and AMC in 2021.

Our jobs as investors and me as a fund manager is to side step these bubbles even if there is short term under-performance.

Taking RISK into consideration is the only way to deliver superior returns over time.

CONCLUSION

From my perspective, Howard Hughes is anticipated to demonstrate substantial long-term growth potential and thus, I intend to maintain a long-term investment in the company. This investment strategy implies a low likelihood of divestment under normal circumstances. Nonetheless, consistent with my investment philosophy, I will continue to diligently monitor the performance of this investment. Should there be evidence suggesting a deviation from my initial thesis, I will promptly consider adjusting our position accordingly.

I would welcome any feedback you may have on this document and as always feel free to reach out to me by email or phone if you have any questions.

We are in this journey together, **our biggest advantage is going to be our collective focus on the long term** along with my skills on capital allocation.

APPENDIX

I want to mention some references that I have used for ideas on writing this document.

First, Nick Sleep and Qais Zakaria, of Nomad Investment Partnership, routinely supplied their investors with such documentation. A common theme could be seen across my investment philosophy and how I manage the fund, similar to that of Nomad, which closed in early 2014. (Thankfully, as otherwise they would have remained the best game in town—though I would still have competed with them!)

Other Tools and websites used-

1) TIKR - Analytical tool to analyze financial metrics

2) Value Investor Club, YouTube Videos, Gemini, Google, HHH Investor relation website

3) Charlie Billello videos and emails (for Bubbles section).

Thank you for taking the time to read this and as always, if there are any questions please do not hesitate to reach out to me.

Sincerely,

Pratik Kodial