BARRON'S

Q&A

Marty Whitman Still Dives Deep For Value

By Lawrence Strauss Updated May 6, 2003 4:56 p.m. ET

Top Holdings | Performance Snapshot

AT 78, MARTIN J. WHITMAN has been in the investment business for more than half a century. He started his career in 1950 (before many of the current Wall Street players were born) as a research trainee at Shearson Hammill, which became part of what's now the Salomon Smith Barney-Citigroup empire. In 1974, Whitman founded M.J. Whitman & Co. Inc., whose money-management business was folded into what is now Third Avenue Management. A deep-value investor who has an eye for distressed assets, Whitman can hold stocks for years. But he also dabbles in distressed debt from time to time -- most recently bonds issued by Kmart. The fund has had a tough time lately, down 16.74% over the last 12 months, which trails the Standard & Poor's 500 Index by 4.63 percentage points, according to Morningstar. The fund's five-year annualized return of 3.18%, however, tops the benchmark index by more than five percentage points, placing it in the top 28% of its Morningstar category.

Barron's Online: *What's your first pick, Marty?*
Marty Whitman: Toyota Industries (no ADR). It's a longtime holding for us. They are the largest shareholder of Toyota Motor, and it is a magnificent worldwide manufacturing company. If you adjust their accounting to pick up their equity in the undistributed earnings of Toyota Motor and other portfolio holdings, the common stock is selling at around eight times earnings on what Warren Buffett calls a "look-through" basis.

Q

Third Avenue Value Fund

(Top 10 Holdings as of March 31, 2003)

Company	Ticker
Toyota Industries	No ADR
Tejon Ranch	TRC
MBIA	MBI
Millea Holdings	MLEA (ADR)
Forest City Enterprises	FCE.A
St. Joe Company	JOE
AVX	AVX
Radian Group	RDN
First American	FAF
Legg Mason	LM

: *So, they're the largest shareholder of Toyota Motors?*
A: Yes, they founded Toyota Motor.

Q: *Is it a holding company?*
A: No, I wish it were. Most of its assets are in marketable securities, principally Toyota Motor. But it [also]

has this magnificent worldwide operating business, which makes maybe $400 million a year operating income. It's the world's largest manufacturer of automobile air-conditioning compressors.

Q: *You said that on a "look-through" basis, it's trading at about eight times trailing earnings?*
A: Yes, if you look at reported earnings, it's around 20 times. But if you pick up the equity and the undistributed earnings of Toyota and other portfolio companies, it's about eight times earnings.

Q: *What do you think the stock's worth? What is a more realistic multiple?*
A: I don't think a company like this could exist in the United States. They would split it into two parts -- an investment company and an operating company.

Q: *What's the stock trading at right now?*
A: About 15 [dollars], and we certainly think it's worth 30 [dollars].

Q: *How about another pick?.*
A: Forest City Enterprises (FCE.A).

Q: *What's their market cap approximately?*
A: It's the biggest blue chip nobody ever heard of. They're on the Big Board. They have, say, 23 million shares at around 40, so its market cap is close to $1 billion.

Q: *As I understand it, they own, develop and manage real estate.*
A: Yes, mostly offices, and they have some residential apartments.

Q: *Where's the stock in relation to its 52-week high?*
A: Forest City is at 37 now. The high last year was 41.

Q: *Where's the value here?*
A: Just by capitalizing their income-producing properties alone, with an 8.5% cap rate, you would get a value close to 50. (*Editor's note: A "cap rate" is the discount rate used to calculate the present value of a future stream of cash flows, in this case rents.*) It's a going concern; it's worth a premium. They've been great at creating values. Their holdings include the 42nd Street Retail and Entertainment Complex [in New York City].
Q: *Please explain what you mean by this company capitalizing its income-producing properties.*
A: They have free cash flow from operations. Let's say they have a fully [rented] office building, they can pick up the phone and sell it. And normally the market for those things is, say, an 8.5 % cap rate. Virtually all their debt is nonrecourse, it just attaches to the property. (*Editor's note: Nonrecourse debt is debt for which the borrower is not personally liable.*)

Q: *What about in terms of any other valuation metric, P/E or otherwise? How attractively is it valued?*
A: I think it would be six or seven times 2003 free cash flow.

Q: *And you think that's still a nice discount to what it's worth.*
A: Yes, I do.

Q: *How about one more pick?*
A: Let's pick up AVX Corp. (AVX), which is on the Big Board. Its market cap is about $1.8 billion.

Q: *What's their niche?*
A: They are the world's largest manufacturers of passive components.

Q: *Passive components?*
A: Yes, this electronic crap, and they have cash well in excess of all liabilities. That's a typical high-tech thing we do. They have something like $800 million in cash.

Q: *So, if you back out that cash, it's probably pretty attractively valued, right?*
A: Yes. The other thing is that it's selling [at] about three times peak earnings. It will take a long time to get back to the peak. It sells at 10, and probably has basic earnings power of $1.50 to $2.00 per share. At the end of 2002, it had $416 million of cash on 180 million shares -- and total liabilities are about $182 million.

Q: *If you back that out, it's trading at less than four times earnings?*
A: I think that's a wrong type of calculation in that not all of the cash is free cash.

Q: *Because they have liabilities as well?*
A: Not only do they have liabilities, they are building new plants. They've got all kinds of commitments, so probably $350 million is surplus cash.

Q: *That would still be $2.00 per share in cash.*
A: Yes, that's true.

Q: *Is this company earning anything right now?*
A: No.

Q: *That $1.50 to $2.00 per share in earnings is a couple of years out?*
A: I would think so.

Q: *What year?*
A: Maybe by the end of 2004. One of the things we've done is signed off on the digital revolution. The surviving high-tech companies probably face pretty good long-term growth trends.

Q: *Why aren't they making any money right now?*
A: Business [is lousy]. Price competition is unbelievable.

Q: *Are the peak earnings $1.50 to $2.00 per share.*
A: No, no, the peak earnings are about $4.00.

Q: *What do you think the stock is worth? Can it get a higher P/E multiple?*
A: Yes, of course. It's typical of Wall Street. Wall Street double counts. When earnings are growing, you not only get the benefit of the growth, but you get the benefit of growth in the multiple.

Q: *Thanks very much, Marty.*

Performance Snapshot

(Total Returns as of May 5, 2003)

	Year-to-Date	1-Yr.	3-Yr.*	5-yr*
Third Avenue Value Fund	3.48%	-16.74%	-3.01%	3.18%
S&P 500	5.93%	-12.11%	-12.26%	-2.29%

Source: Morningstar

*annualized

E-mail comments to
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Manager's Bio:

Name: Martin Whitman

Age: 78

Title: Co-chief investment officer of Third Avenue Management LLC; Chairman and portfolio manager of the Third Avenue Value Fund

Education: Undergraduate degree in business from Syracuse University; MA in economics from the New School of Social Research

Hobbies: Playing tennis

Other professional activities: Teaches at the Yale School of Management; author of "The Aggressive Conservative Investor and Value Investing: A Balanced Approach."

Investment Philosophy

* A deep value investor, Whitman looks for companies with strong financial positions and that are "reasonably well managed."

* "We're only in businesses we understand," he says, and he and his staff try to figure those businesses out by digging through documents. Whitman generally won't pay more than 50% of what he deems a stock would be worth in a private takeover.

* Though he's had plenty of success with his investing approach, Whitman isn't shy about pointing out its shortcomings. For one thing, the emphasis on strong financial positions skews toward "very conservative managements [that] basically don't need access to Wall Street [and] are willing to sacrifice [return on equity] for safety and dry powder," he explains.

* As for assessing management, "we screw up there more than anyplace else," he says. "Appraising management is tough." What's more, takeovers don't always produce the premiums that Whitman hopes for.

Whitman's Favorite Stocks

Company	Ticker	Recent Price
Toyota Industries	No ADR	15
Forest City Enterprises	FCE.A	37.27
AVX	AVX	10.33