Gulf Island Fabrication, Inc. (NASDAQ: GIFI)

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GLOBAL VALUE RESEARCH COMPANY
A Division Of Global Value Investment Corp

RATING: BUY **PRICE TARGET: $18.15**

SHORT-TERM LIQUIDITY CRUNCH CLOUDS LONG-TERM POTENTIAL

Summary

Gulf Island Fabrication, Inc. ("Gulf Island") is a leading fabricator of complex offshore steel structures, marine vessels and onshore petrochemical and industrial facility components. The company also provides marine vessel maintenance and repair services and offshore installation, hookup, commissioning, maintenance and repair services. Founded in 1985, Gulf Island has long been involved in the construction of offshore oil production facility components, including fixed production jackets and platform topside components. Through its shipyard operations, grown recently through acquisition, the company has constructed a variety of vessels, including barges, tugboats, liftboats, offshore service vessels (OSVs), multi-purpose service vessels (MPSVs), government and military craft and passenger ferries. In 2015, Gulf Island fabricated five wind turbine pedestals for the first offshore wind power project in the United States, the Block Island Wind Farm.

The steep decline in the price of oil that began in mid-2014, and the associated reduction in capital expenditures by offshore oil and gas producers, has forced Gulf Island to transition its business away from its traditional core oil-and-gas-associated operations. This process is well underway and there are positive signs of success in the company's pivot. However, cost overruns and contract disputes with legacy customers have proven materially detrimental to the company's financial condition. Recent operating results and poor project execution have given rise to serious concerns about short-term liquidity. While these short-term issues have shaken investor confidence, Global Value Research Company does not share the market's dire outlook. Gulf Island boasts a meaningful backlog, has been awarded significant contracts and anticipates substantial order inflow from new projects. Furthermore, the company has several acceptable options to increase short-term liquidity. Gulf Island's current enterprise value (EV) is about $113.6 million; should assets held for sale of $104.6 million be sold at book value, the company's EV would approach zero. Global Value Research Company believes that such a valuation would grossly understate Gulf Island's intrinsic value, which GVRC assesses as a multiple of tangible book value (TBV) commensurate with historic valuations. Global Value Research Company therefore initiates coverage with a buy rating and a target price of $18.15.

PLEASE SEE ANALYST CERTIFICATION AND IMPORTANT DISCLOSURES ON PAGE 10.

Stock Information

Current Price:	$8.15
52-Week Range:	$6.90-$13.95
Avg Daily Volume:	77,614
Dividend Yield:	-
Shares Out (MM):	15.0
Float %:	82.7%
Market Cap (MM):	$122.6
Total Debt (MM):	$0.0
Cash (MM):	$9.0
Enterprise Value (MM):	$113.6

Financial Metrics

TTM Revenue (MM):	$171.0
TTM EBIT (Adj., MM):	($68.6)
EV/EBIT:	N/A
Tangible BV/Share:	$14.53
P/TBV:	0.56x

Company Description

Gulf Island Fabrication, Inc. engages in the fabrication of steel structures and marine vessels used in energy extraction and production, petrochemical and industrial facilities, power generation and alternative energy projects and shipping and marine transportation operations. It operates through four business segments: fabrication, shipyard, services and EPC. The fabrication segment includes fabrication of structures such as offshore drilling and production platforms and other steel structure for customers in the oil and gas industries, as well as offshore alternative energy and onshore petrochemical facility components. The shipyards segment manufactures and repairs various marine vessels. The services segment provides interconnect piping services on offshore platforms and inshore structures. The EPC segment provides engineering and project management services. Gulf Island Fabrication, Inc. was founded by Alden Laborde in 1985 and is headquartered in Houston, Texas.

Figure 1: five-year performance chart. Source: FactSet; data as of 4/6/2018.

Business Description

Gulf Island operates through four segments: fabrication, shipyard, services and engineering, procurement and construction (EPC). Through its fabrication division, the company fabricates structures such as offshore oil and gas drilling and production platform components, including fixed platform jackets and piles, floating platform hulls and tendons, platform deck sections, wellhead protectors, subsea templates and various other offshore infrastructure components. The company also fabricates jacket and monopile foundations for offshore wind energy developments, as well as onshore petrochemical plant processing modules. Through its shipyard division, the company builds and repairs a variety of vessels, including those employed in support of offshore oil and gas exploration and production and ongoing support operations, tugboats, barges, ferries and other vessels. The shipyard division is currently building or planning to build offshore service vessels, multi-purpose service vessels, regional class research vessels, tugboats and towing, salvage and rescue ships. Through its services division, the company provides interconnect piping services, scaffolding and piping insulation services to onshore and offshore oil and gas companies, as well as various other marine-related construction and maintenance activities. Finally, through its newly-formed EPC division, the company plans to provide project management services in connection with an anticipated contract that will retain the company as the prime contractor for a large onshore petrochemical plant fabrication project. The EPC division was financially immaterial as of December 31, 2017.

Balance Sheet

For the three months ended December 31, 2017 (FQ4 2017), Gulf Island's current assets were $179.2 million, which consisted of $9.0 million in cash and cash equivalents, $28.5 million in net contracts receivable, $28.4 million in contracts in progress and $104.6 million in assets held for sale. FQ4 2017 current assets compare unfavorably to FQ3 2017 current assets ($209.6 million), but favorably to FQ4 2016 current assets ($113.4 million). In FQ1 2017, $110.5 million of net property, plant and equipment was reclassified as assets held for sale; the majority of this balance has yet to be sold. The company's cash balance has declined dramatically, from a recent high of $55.6 million in FQ3 2016 to only $9.0 million in FQ4 2017. The use of cash is attributable to operating losses throughout 2017, which were considerable in FQ4 2017. In January 2018, the company drew on its revolving credit facility due to continued negative cash flow. Long-term assets of $91.7 million are composed largely of net property, plant and equipment ($88.9 million), and total assets are $270.8 million.

Current liabilities of $48.7 million compare favorably to current assets of $179.2 million (including assets held for sale), and even when excluding assets held for sale, this relationship is acceptable (current ratio is 3.68, adjusted current ratio is 1.53). The company reported no debt as FQ4 2017, and non-current liabilities totaled only $2.7 million. GVRC expects an increase in debt as the company continues to draw on its revolving credit facility for short-term liquidity needs. Although GVRC anticipates a gradual improvement in operating income, certain contracts will likely produces losses in FQ1 2018, and progress on several new awards will not generate significant revenue until mid-2018.

Gulf Island reported $88.5 million in contractual obligations and commitments as of December 31, 2017, $60.1 of which will be realized in FY 2018. The vast majority of this balance is represented by purchase commitments of material and services, with minimal amounts attributable to operating leases and purchase commitments of equipment. Gulf Island also leases certain equipment under month-to-month lease agreements, although the expense is immaterial ($1.0 million in FY 2017).

Liquidity Issues

On November 17, 2017, Gulf Island filed a Form S-3 shelf registration with the Securities and Exchange Commission to sell up to $200 million in equity or debt securities. While this may have been preemptive and overly-cautious as the company finalizes a very large contract (see Business Diversification and Backlog Review section below), the shelf filing is indicative of a larger liquidity problem. Operating income has been negative for five consecutive quarters, and for seven of the past 10 quarters. Cash from operations has been negative for five consecutive quarters, and for eight of the past 10 quarters. Competitive bidding during the oil and gas downturn, cash-strapped customers and contract mismanagement (see Contract Issues section below) have plagued Gulf Island. With a 2017 year-end cash balance of $9.0 million, short-term liquidity has emerged as a serious concern.

The company has several options at its disposal to increase liquidity. First, its assets held for sale of $104.6 million may be sold. The vast majority of this balance is made of up two fabrication yards in the Corpus Christi, Texas area ("North Yard" and "South Yard"). Both are located on navigable waterways and appear to be desirable locations. In December 2017, Gulf Island entered into a real estate purchase option and contract (expires April 25, 2018, optional one-month extension) with Buckeye Pipe Line Co., L.P. to sell the South Yard for $55 million (book value is $46.8 million). Gulf Island's senior management has indicated that there are several buyers interested in the North Yard as well.

Second, the company has a revolving line of credit with a $40.0 million limit. In January 2018, Gulf Island drew $10.0 million under this credit facility in order to meet working capital requirements. After accounting for this draw and outstanding letters of credit, about $27.5 million remains available. Alternatively, Gulf Island could seek additional bank financing by offering unencumbered equipment as collateral, or bridge financing collateralized by its asset held for sale.

Third, Gulf Island is currently involved in litigation with Walter Oil & Gas Corporation ("Walter Oil"), and is seeking $34.6 million for change orders in excess of the original contract price for a jacket fabricated and delivered in late 2015. Gulf Island has attempted to settle this litigation with Walter Oil, to no avail. While the suit is not scheduled to be heard until late 2018, the possibility of a settlement, and payment, remains.

Finally, should Gulf Island deem it necessary to issue additional securities, management has indicated that it would prefer a rights offering in order to minimize dilution for existing shareholders. While GVRC anticipates that the market will reactive negatively to any equity offering, a rights offering would seem preferable to shareholders.

Income Statement

For the three months ended December 31, 2017 (FQ4 2017), Gulf Island generated $37.3 million in revenue: $15.4 million from the fabrication division, $0.9 million from the shipyard division, $21.7 million from the services division and -$0.7 million attributable to corporate and intersegment eliminations. FQ4 2017 revenue represented the lowest quarterly revenue in 10 years, and compares to a June 2013 high of $165.6 million. Quarterly revenue throughout 2017 was modest (<$50 million per quarter), and losses in the shipyards division were detrimental. Several of Gulf Island's customers are offshore oil and gas producers or offshore service companies, and the impact of depressed offshore oil and gas capital expenditures has significantly affected customer budgets. However, the frequency with which Gulf Island has experienced contract losses and recent magnitude of those losses is unsettling. A full discussion of customer-specific issues is included in the Contract Issues section below.

FQ4 2017 cost of revenue was $63.2 million, resulting in a gross profit of -$25.9 million. Only the services division showed a positive gross profit ($2.2 million, on revenue of $21.7 million). General and administrative expenses were $4.9 million, and the company recognized $7.3 million in asset impairments. Operating loss was $38.1 million, and after a $13.9 million income tax benefit, net income was -$24.3 million. For FY 2017, gross profit was -$42.9 million, operating income was -$68.4 million and net income was -$44.8 million. Losses throughout the year were largely attributable to cost overruns and delays on existing shipyard contracts.

Contract Issues

Gulf Island has a long history of providing fabrication and shipbuilding services, and has historically done so profitably. For the 10 years immediately prior to FQ3 2015, the company produced both a gross profit and operating profit in 36 out of 40 quarterly periods, and a positive net income in 35 out of 40 quarterly periods.

In late 2015, Gulf Island delivered a jacket for Walter Oil's Coelacanth project. Because the execution of certain work called for in the contract required additional work, labor and materials, between March and August of that year, Gulf Island submitted multiple change orders to Walter Oil. Subsequently-filed court documents indicate that Walter Oil provided written correspondence confirming its willingness to pay these change orders once the load-out of the structure was completed, but payment never occurred. In April 2016, Gulf Island filed suit in Plaquemines Parish, Louisiana, seeking recovery of $34.6 million in unpaid invoices. The suit is still pending.

In January 2016, Gulf Island completed the acquisition of LEEVAC Shipyards, LLC ("LEEVAC"). For a purchase price of $20.0 million, Gulf Island added $112.0 million of incremental contract backlog and received $1.6 million in cash at closing. Included in the backlog were contracts with Tidewater, Inc. ("Tidewater") for two offshore service vessels and Hornbeck Offshore Services, Inc. ("Hornbeck") for two multi-purpose service vessels.

When the first offshore service vessel constructed for Tidewater was completed in February 2017, Tidewater rejected delivery, alleging certain technical deficiencies (which Gulf Island contested) and withholding $4.6 million in remaining payments. Shortly thereafter, construction on the second offshore service vessel, for which there was an outstanding balance of $4.9 million, was halted. In May 2017, Tidewater entered Chapter 11 bankruptcy proceedings, which lasted until July 2017. Larry Rigdon was appointed as the company's interim CEO in October 2017, at which point Gulf Island and Tidewater reached an agreement under which Tidewater accepted delivery of the vessels for a modestly reduced price. Gulf Island has entered into agreements with Tidewater for vessel storage and maintenance services, and while this issue was resolved amicably, it raised concerns about the rigor of Gulf Island's contracts review process and negotiating position.

On March 19, 2018, Gulf Island received a letter of termination from Hornbeck in connection with the two multi-purpose service vessels under construction. Progress on these vessels had been troubled due to their technical sophistication, and difficulties were encountered with the engineering and electrical complexities of the power and communication systems, which required significant reworking. In FQ4 2017, Gulf Island recorded contract losses of $34.5 million, including $11.2 million in liquidated damages, related to cost overruns and delays in the construction of these vessels. Concurrently, delivery was pushed from 2018 into 2019. While GVRC views the letter of termination from Hornbeck as a short-term positive, as Gulf Island consistently experienced contract losses on these two vessels, a favorable long-term resolution seems unlikely.

Gulf Island's difficulties in carrying out the contracts with Tidewater and Hornbeck, both assumed in the LEEVAC acquisition, are troubling. Although the counterparties to these contracts have both experienced operational and financial stress as a result of depressed offshore activity, the ramifications for Gulf Island have been materially detrimental. The company believes that it has strengthened its contracting, planning and project management processes as a result of recent losses. Shipyard contracts currently in progress will demonstrate or disprove such improvements.

Cash Flow
For the three months ended December 31, 2017 (FQ4 2017), Gulf Island generated cash from operations of -$9.8 million, which included a $13.0 million payment of deferred income taxes, a $17.1 million benefit from costs and estimated earnings in excess of billings on uncompleted contracts and a $5.6 million benefit from accrued contract losses. Cash from investing was $1.3 million, attributable to proceeds from insurance recoveries of $1.5 million, offset by minimal capital expenditures of $0.3 million. Cash from financing was -$0.2 million, primarily from the payment of the $0.01 quarterly dividend, which was suspended after FQ4 2017.

Gulf Island's Texas fabrication yards (North Yard and South Yard, both held for sale) sustained damage when Hurricane Harvey made landfall on August 25, 2017. The company's initial estimate of the claim due is $21.5 million, of which $6.0 million has been advanced by the company's insurance underwriters. GVRC anticipates that the insurance proceeds will be in excess of repairs made to each property, although sale values may be affected by the damage.

Shareholders' Equity
Shareholders' equity has eroded consistently since mid-2015. While the company's inability to stymie this trend is disappointing, operating results have been hindered by both the industry environment and atypical contract-specific issues. Counterparties to Gulf Island's newly-awarded contracts are predominately outside of the offshore oil and gas production or offshore service industries and appear well-capitalized. Project scopes are similar to those that Gulf Island has historically executed at a profit. GVRC expects a gradual pickup in revenue, gross profit and operating income.

Business Diversification and Backlog Review
As the oil and gas downturn took hold in mid-2014, Gulf Island began to implement a number of initiatives designed to strategically reposition the company to attract new customers and move into markets less correlated to offshore oil and gas capital spending. Successes from this repositioning are already evident: the company is currently completing the fabrication of four ethane cracker modules for Chicago Bridge and Iron Company in connection with a new onshore petrochemical plant in Louisiana, and during 2015, Gulf Island fabricated five wind turbine pedestals for the first offshore wind power project in the United States, the Block Island Wind Farm.

In late 2017, SeaOne Caribbean, LLC ("SeaOne") selected Gulf Island as the prime contractor for the engineering, procurement, construction, installation, commissioning and start-up for the Compressed Gas Liquids Caribbean Fuel Supply Project, which encompasses a new compressed gas liquids export facility in Gulfport, Mississippi and import facilities in the Caribbean and South America. Construction is expected to being in late 2018 or early 2019. SeaOne's selection of Gulf Island is non-binding, but provided the two companies reach an agreement on terms, an announcement should be forthcoming. While the scope of the project is unclear, Gulf Island's management has suggested that it may add between $1 billion and $3 billion to the company's backlog.

On April 3, 2018, Bay State Wind, a joint venture between Ørsted and Eversource Energy, entered into an agreement with EEW to open and staff a facility in the Northeastern United States to manufacture offshore wind components. EEW will collaborate with Gulf Island on the production of monopile foundations and transition pieces, including secondary steel components, painting and pre-fabricated components for offshore wind turbine foundations. GVRC predicts that several offshore wind energy developments will be commissioned in coming years, and Gulf Island is uniquely positioned to capitalized on this opportunity given its experience in the fabrication of structures for such developments.

Concurrently, the company has attracted shipbuilding customers outside of the offshore oil and gas production and offshore services industries. In June 2017, Gulf Island announced a contract with Suderman & Young Towing Company for the construction of four Z-Tech 30-80 class terminal/escort tugboats and a contract with Bay Houston Towing Company for the same number of identical vessels. These eight vessels added about $82 million to the company's backlog.

In July 2017, Oregon State University awarded Gulf Island a contract to construct a Regional Class Research Vessel with an option for two additional vessels. The order for the 193-foot-long vessel added about $70 million to the company's backlog. While funding for two additional vessels, which is provided through the National Science Foundation (NSF), is far from certain, the NSF has solicitated proposals for operating institutions for these vessels. The solicitation indicates construction start dates of June 2018 and June 2019, and vessel delivery dates of October 2021 and October 2022, for each additional vessel, respectively.

In December 2017, the Saint Lawrence Seaway Development Corporation awarded Gulf Island a contract to construct an ice class, CPP Z-drive tugboat. The order for the 118-foot-long vessel added about $18 million to the company's backlog.

In March 2018, the United States Navy awarded Gulf Island a contract to construct a towing, salvage and rescue ship with an option for seven additional vessels. The order for the first vessel added about $64 million to the company's backlog; if all options are exercised, the total value of the contract will be about $523 million. Gulf Island's management believes there is a high likelihood that all seven options are exercised.

Other projects in Gulf Island's backlog include the completion of one offshore service vessel for Tidewater (*Young* Tide) and two multi-purpose service vessels for Hornbeck (*HOS Warhorse* and *HOS Wild Horse*).

Management and Governance

Kirk Meche has been the CEO of Gulf Island since January 2013 and has been with the company since 2001. He has extensive experience in marine engineering and project management. Mr. Meche's 2017 compensation totaled $2,198,970, consisting of $500,000 in salary, $1,539,995 in stock awards, $125,000 in non-equity incentive plan compensation and $33,975 in all other compensation. He currently owns 2.2% of the common stock outstanding. Mr. Meche's tenure in the industry has resulted in several professional relationships which GVRC believes are material to the company. Gulf Island's 2017 resolution with Tidewater was resolved in large part due to Mr. Meche's professional relationship with Tidewater's new management. Furthermore, while Gulf Island's recent operating performance has been disappointing, Mr. Meche has served in management capacities with Gulf Island for nearly 20 years, during which time the company has shown much more encouraging results.

David Schorlemer has been the CFO of Gulf Island since January 2017. He has previously served in various financial or other senior officer positions with companies in the energy services industry, and has participated in or overseen numerous corporate transactions. Mr. Schorlemer's 2017 compensation totaled $1,020,696, consisting of $340,000 in salary, $616,006 in stock awards, $63,750 in non-equity incentive plan compensation and $940 in all other compensation. He currently owns 0.5% of the common stock outstanding.

Todd Ladd has been the COO of Gulf Island since February 2014 and has been with the company since 2013, and between 1996 and 2001. He has extensive experience in offshore engineering and construction. Mr. Ladd's 2017 compensation totaled $1,223,973, consisting of $350,000 in salary, $769,998 in stock awards, $70,000 in non-equity incentive plan compensation and $33,975 in all other compensation. He currently owns 1.1% of the common stock outstanding.

Gulf Island's Board of Directors is made of up eight individuals. Mr. Meche is a member of the Board of Directors, but is not the chairman. John Laborde serves as the chairman of the Board of Directors, having been a member since 1997. Mr. Laborde has held various operational and management positions with offshore exploration and production comapnies, and is the son of Gulf Island's co-founder, Alden "Doc" Laborde. The three newest members of the Board of Directors, Murray Burns, William Chiles and Michael Keeffe, assumed their seats in 2014. The longest-serving member of the Board of Directors, Gregory Cotter, has served since 1985. Several members have experience in offshore oil and gas, although the experience and background of members does not appear well-aligned with the markets that Gulf Island is now targeting.

Mr. Meche is both the youngest member of the Board of Directors (55) and has the most significant equity ownership (2.2%). The other member of the Board of Directors range in age from 66 to 72, and none own more than 0.2% of the common stock outstanding; excluding Mr. Meche, the other seven member of the Board of Directors collectively own about 0.8% of the common stock outstanding.

2017 total compensation for independent directors ranged from $140,000 - $152,000 with the exception of Mr. Laborde, who earned $213,333. Given Gulf Island's small size, GVRC questions the cost of the Board of Directors, which exceeded $1.1 million in 2017, and the benefits of its large size. Furthermore, considering the advanced age of many members and the strategic direction of the company, GVRC would encourage several retirements in upcoming years, with existing directors replaced by candidates with relevant experience in the shipbuilding or offshore alternative energy fields. On April 6, 2017, Piton Capital Partners LLC filed an amended Scheduled 13D proposing a reduction in the size of the Board of Directors and director compensation. GVRC has spoken with Piton Capital Partners LLC, and believes its proposals to be reasonable.

Shareholders (from recent 13D, 13F, 13G or proxy filings)	
BlackRock Fund Advisors	11.0%
Dimensional Fund Advisors LP	8.4%
Piton Capital Partners LLC	7.9%
Sunriver Capital Management LLC	5.7%
Starboard Enterprises LLC	5.5%
The Vanguard Group, Inc.	5.5%
Pacific View Asset Management LLC	5.3%
Ariel Investments LLC	3.6%
Renaissance Technologies LLC	2.6%
Royce & Associates LP	2.3%
Top 10 Holders	**57.8%**

Industry Overview and Competitive Positioning

The fabrication of offshore structures, onshore petrochemical plant components and the construction of marine vessels are competitive industries, with domestic and international companies vying for market share. Contracts are awarded on a competitive basis, and provide minimal protection against cost overruns. While fabricators and shipyards may attract repeat or recurring business, the large scope of projects and infrequency with which a single customer might order a particular structure or vessel makes future cash flows heavily dependent on the consistent booking of new contracts.

In mid-2014, the price of oil dropped dramatically and has remained below pre-downturn levels for several years, only recently stabilizing in the $60 - $70 per barrel range. This price decline caused many offshore producers to delay, downsize or cancel planned projects, and offshore capital expenditures remain depressed. Furthermore, offshore service companies have been forced to provide services at reduced prices and compressed margins, and have seen a marked decrease in the employment of capital resources. Two of Gulf Island's shipyard customers, Tidewater and Hornbeck, have idled significant portions of their respective offshore service fleets, affecting Gulf Island's ability to generate new orders or complete existing orders for these significant customers.

Gulf Island competes against several well-know and well-capitalized competitors both domestically and internationally. While only a small portion of Gulf Island's revenue is attributable to international orders, several international fabrication companies and shipyards provide similar services. In the fabrication division, Flour Corporation, Kiewit Corporation and McDermott International, Inc. are three of the most prominent competitors. In the shipyards division, Eastern Shipbuilding Group, Inc., VT Halter Marine, Inc. and Bollinger Shipyards are three competitors, although Gulf Island's customers patronize dozens, if not hundreds, of shipyards around the world.

Gulf Island has a unique advantage in the fabrication of offshore wind energy structures because it is the only U.S. company with experience in this area. Its recent partnership with EEW is a testament to the company's leading market position. Offshore wind energy in Europe now generates significant amounts of electricity for certain regions and countries, and many projects, which would have previously required government subsidies, are now viable without subsidies due to large project scopes and advances in technology. The demand for offshore wind energy in the United States has been well-documented, and planning for large projects is well underway in many states, particularly Massachusetts, New York, New Jersey and Maryland.

Valuation Analysis

Note: Global Value Research Company does not premise valuation on financial modeling of future results. Each company analyzed is treated as unique and its value is appraised based on its circumstances and those of the industry and macroeconomic environment in which it operates. Various metrics are used based on a company's characteristics and historical pricing.

Gulf Island's common stock has historically traded at a multiple of tangible book value (TBV), but has recently traded at a fraction of TBV. From FQ3 2009 through FQ2 2014, the company traded at an average of 1.3x TBV. From FQ3 2014 through FQ4 2017, the company has traded at an average of 0.7x TBV. Over the past 10 years, the stock has traded as high as 2.9x TBV (FQ2 2008) and as low as 0.4x TBV (FQ2 2016). The company now trades at about 0.5x FQ4 2017 TBV of approximately $14.50/share.

While GVRC recognizes that ongoing losses have eroded shareholders' equity, which is now $219.5 million (this peaked at $294.3 million in FQ2 2012), the stock has been dramatically discounted recently as concerns about short-term liquidity emerged. GVRC shares these concerns, but believes the company's ability to raise cash is sufficient.

Global Value Research Company believes that Gulf Island will be able to capitalize on opportunities that have stemmed from its diversification efforts. Counterparties to the company's newest contracts are not involved in the offshore oil and gas industry, and appear rational and well-capitalized. Notable project opportunities include SeaOne's Compressed Gas Liquids Caribbean Fuel Supply Project and projects involving the fabrication of offshore wind energy structures. These are similar to past projects that have been undertaken profitably.

Gulf Island has historically had a *raison d'etre* due to its expertise in the fabrication of large offshore structures and its proximity to the Gulf of Mexico, an important offshore oil-producing region. As offshore oil and gas capital expenditures have diminished, so has Gulf Island's niche market. However, the company's expertise in the fabrication of offshore structures is transferrable to offshore wind energy, and its *reason d'etre* is now largely due to its first-mover status in that market. A *raison d'etre* for the shipyard division is more difficult to identify, but Gulf Island's reputation for craftsmanship, coupled with the ongoing global demand for inshore and offshore vessels, is notable.

The value in Gulf Island lies in its assets and their ability to produce future cash flows. The company owns land and several large capital assets, and while much of its capacity is underutilized, several scenarios exist in which such underutilized capacity might be quickly employed. Furthermore, the company's assets currently held for sale should be sold in the near future. Preliminary information suggests that the South Yard may sell for approximately $55 million, versus its book value of about $46 million. Should the North Yard sell at a similar premium to book value, Gulf Island would have a cash balance that, at the current stock price, would cause the EV to approach zero.

To arrive at a target price of $18.15, a 1.25x multiple is applied to the current TBV of about $14.50. Gulf Island has experienced several lean years, but GVRC expects backlog will grow. Should Gulf Island demonstrate profitability on new contracts, as it has been able to do with offshore structure fabrication and onshore petrochemical module construction in the past, a multiple of 1.25x is justified.

Risks, Catalysts and Expectations

Expectations for Gulf Island's future operating performance could be hampered in a number of ways. Chief among these risks are the following:

- The company is unable to execute satisfactorily, from an operational or financial standpoint, on its new contracts, and losses continue.
- The multi-purpose service vessels currently under construction for Hornbeck result in protracted litigation, the cost or results of which are materially detrimental to Gulf Island's financial condition.
- The company otherwise mismanages its financial resources, including disposing of assets in exchange for liquidity at unfavorable prices, or entering into financing arrangements on unfavorable terms.
- Equity is issued in a manner that dilutes existing shareholders, and at the current depressed stock price.
- Mr. Meche leaves the company, and existing or potential customer relationships suffer.

Absent the materialization of the above risks, GVRC expects revenue and operating characteristics to gradually improve as new contracts are undertaken in a profitable manner and the company remains properly diversified in relation to the cyclical capital expenditures of offshore oil and gas producers and offshore service companies. Among potential catalytic events are the following:

- The receipt of cash from the sale of the North Yard, South Yard, other non-essential equipment or a favorable settlement of the lawsuit with Walter Oil.
- Signing a binding contract with SeaOne that involves a large upfront cash payment and provides clarity around the scope of work to be performed under the contract.
- The favorable settlement of the company's contract dispute with Hornbeck and a clearly-defined path to the completion of the two multi-purpose service vessels.
- A long-term contract for the fabrication of a large number of structures for offshore wind energy developments, resulting in an addition to backlog to be realized over several years.
- Additional meaningful contract awards from stable counterparties in industries outside of offshore oil and gas, or a contract award from a large integrated oil and gas company with less counterparty risk than certain previous customers.
- Improvement in the future pricing for oil and gas, less regulation of offshore oil and gas operations or another factor that would encourage substantial offshore infrastructure development in the Gulf of Mexico.

Global Value Research Company expects Gulf Island to incrementally add contracts to its backlog that represent its ongoing shift away from its traditional offshore oil and gas industry customers, while completing its existing contracts with fewer contract losses. In doing so, the company will demonstrate its value as a going concern to market participants, and investors will recalculate the company's market value. In the short-term, GVRC expects the company to raise cash through one of the non-dilutive aforementioned options, which should alleviate concerns about insolvency or equity dilution. As the company's financial condition and operating characteristics improve, GVRC expects shares to trade towards their historic P/TBV multiple of 1.25x.

In conclusion, GVRC places a buy recommendation when it believes share can be purchased at a 50% of greater discount from appraised value. Gulf Island currently trades at a 60% discount to GVRC's target price of $18.15 per share. GVRC believes this discounting to be overly-dramatic, resulting in an attractive entry point for opportunistic, long-term investors. GVRC remains mindful of possible mismanagement of the company's financial resources, especially given its tenuous cash position, as well as signs of poor execution of new and yet-to-come contracts, but is cautiously optimistic that unique opportunities will produce attractive financial results for patient investors.

About Global Value Research Company

Global Value Research Company is the investment research division of Global Value Investment Corp., a research and advisory firm serving individual and institutional clients. Founded in 2007 in Milwaukee, Wisconsin, the firm currently operates additional offices in Boston, Massachusetts, Charleston, South Carolina and Hyderabad, India. Global Value Research Company espouses the value investing principles pioneered by Ben Graham and David Dodd, providing comprehensive fundamental analysis of publicly traded companies around the world. Our research process focuses on diligently examining company financial statements, understanding competitive positioning, assessing industry and macroeconomic trends and speaking with company senior management on an ongoing basis. Further information about Global Value Research Company's services can be obtained by contacting the firm directly.

Ratings

Buy: Security is currently trading at a discount to appraised value such that we expect it to produce an annualized return of 15% or greater over a hypothetical five-year holding period based on our view of the company and industry fundamentals, catalysts, risks and valuation.

Hold: Security is currently trading at a discount to appraised value such that we expect it to produce an annualized return of less than 15% over a hypothetical five-year holding period, or a company is trading a modest premium to appraised value and we expect minimal risk of capital impairment with moderate possibility of further appreciation based on our view of the company and industry fundamentals, catalysts, risks and valuation.

Sell: Security is currently trading near, at or above appraised value and we do not expect significant appreciation, or the risks of holding the security outweigh the possibility of further appreciation based on our view of the company and industry fundamentals, catalysts, risks and valuation.

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