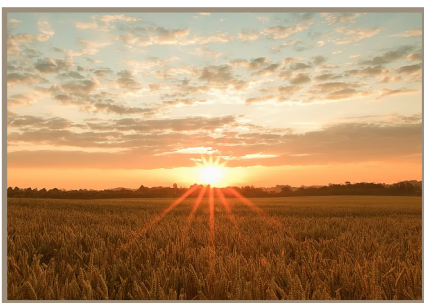


Let Slip the Doves of Easing

And just like that, the rate-hiking cycle which began in March of 2022, ended with a 50 bps bang.

There is no shortage of armchair quarterbackbacks when it comes to assessing the FOMC's actions, and critics have been quick to point out the fact that the Fed is now cutting rates with a wide variety of asset prices (stocks, houses, etc.) near all time highs.

From where we sit, we view second-guessing the dealer (don't fight the Fed) as a waste of time. Rather, we aim to play the hand that is dealt, whatever it may be, and seek out the resulting opportunities. There is little doubt that many will materialize and we are excited to continue the path forward amidst this new cycle.



Macro focus

We take a closer look at the Fed's more material talking points from the recently completed FOMC meeting, along with their latest guidance.

Going forward, the elephant in the room continues to be inflation—specifically, the risk that the Fed has cut too much and too soon, which could cause a reacceleration of inflationary pressures.

We examine trends in the underlying components of inflation measures and where the risks lie. We then close our macro focus by reviewing the case for credit investments (IG and HY bonds) at this junction in the markets.

Single-name stock highlight

In this issue we will review Borr Drilling Limited (BORR), the owner/operator of the world's youngest fleet of offshore oil & gas jack-up drilling rigs.

The bullish investment thesis in Borr is a classical case of an imbalance of supply and demand which is tilted to Borr's favor as their earnings are likely to inflect significantly higher. See page 5 for the full review.

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RECENT DEVELOPMENTS

- FOMC cuts policy rate by 50 bps from a target rate of 4.75% to 5.00%
- China announces a potpourri of easing measures —decreasing rates, stoking equity purchases, and promises of fiscal spending, with potentially more to come
- Payrolls continue to thread the needle, with 142k jobs added in September
- Markets experience heightened sector dispersion as U.S. indices trade around all time highs. Consumer cyclicals and utilities (of all things) are leading on the month as the semiconductor trade continues to struggle

KEY UPCOMING EVENTS

- September non-farm payrolls and unemployment rate: Oct. 4
- CPI data release: Oct. 10
- Q3 earnings season informally kicks off Oct. 11, with mega cap financials JPM, WFC, PGR, and BLK reporting

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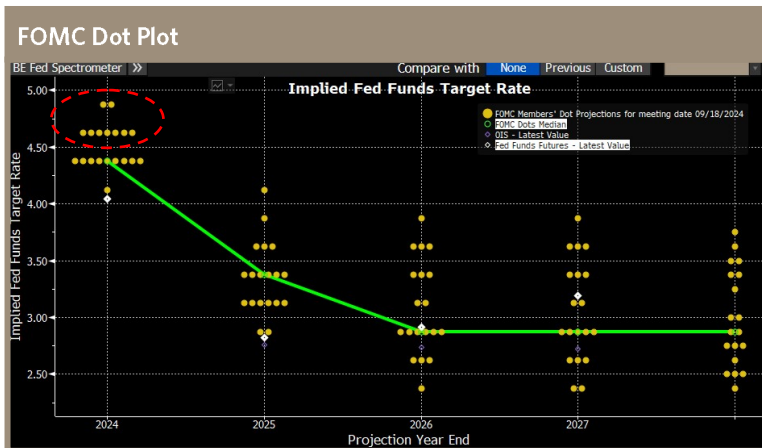
Monetary Policy (U.S.A.)

“Fifty nifty United States...” We can finally stop speculating on whether the Fed would cut 25 or 50. To the surprise of most economists, the Fed decided during its September meeting to cut the policy rate by 50 basis points, and the SOFR Index has now moved from 5.33% to 4.83%.

We thought that this was the most important part of Powell’s statement:

“This recalibration of our policy stance will help maintain the strength of the economy and the labor market and will continue to enable further progress on inflation as we begin the process of moving toward a more neutral stance. We are not on any preset course. We will continue to make our decisions meeting by meeting.”

The cut is being dubbed a “recalibration” rather than the start of an aggressive cutting cycle. In the Fed’s latest Summary of Economic Projections (SEP) the 2024 median dot was moved down from 5.1% to 4.4%, the 2025 dot moved down from 4.1% to 3.4%, the 2026 dot moved from 3.1% to 2.9%, and the long-run dot moved up from 2.8% to 2.9%. Each dot represents each of the committee members’ projections for future Fed funds rates.

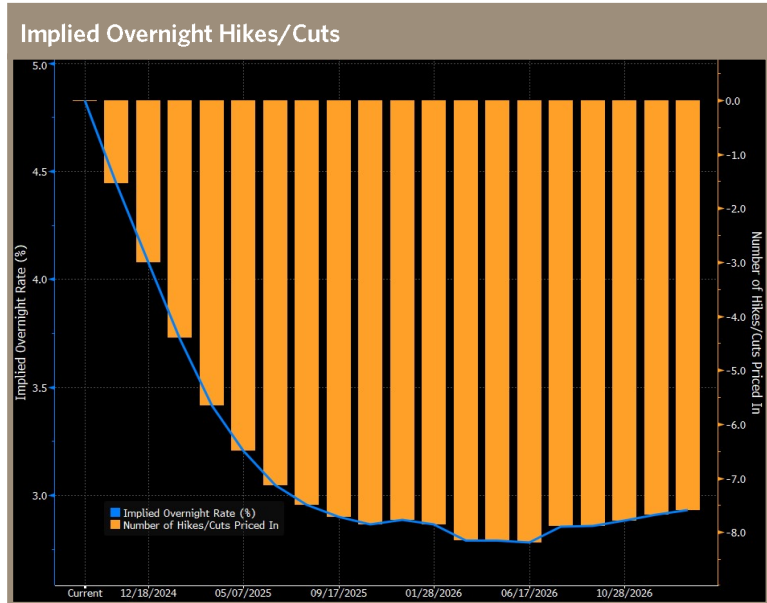


It’s interesting to note that while the median dot shows two more cuts into year-end, nearly half the participants (circled in red in chart above) see only one cut by year-end. This is in stark contrast to the market, which is projecting three more cuts by year-end.

The committee projected real GDP to stay around 2% for the foreseeable future. The largest change in the SEP was the uptick in projected unemployment from 4.0% at year end 2024 to 4.4%, which tracks with more recent data and also displays the committee’s fears on labor; however, they do see it stabilizing at 4.4% before coming back down to 4.2% in the long run. Lastly, they moved down their PCE inflation projections slightly for 2024 and 2025.

In summary, the projections generally exhibit the Fed’s optimism for a

soft landing. They believe growth will hold up, inflation will come down, and the labor market will continue to normalize, all of which gives them a runway to bring the policy rate down to ~3%. The STIR market is pricing something similar in the long run, but at a faster pace. The STIR market sees policy getting to that 3% level by summer of 2025, which implies another 7-8 cuts in just 9 months. We think the market is a bit optimistic in its pricing; however, we recognize that the market must also put some weight on the probability of a hard landing.



Inflation

As the Fed grows ever more confident in their fight against inflation, let’s take a deeper dive under the hood to understand the underlying components and how confident we really should be that inflation will be brought back to target in a timely manner.

First, we should recognize that economists have a terrible track record of predicting inflation and that there is little value in looking at economists’ projections for inflation. But there is value in understanding market expectations as asset prices will take inflation expectations into account.

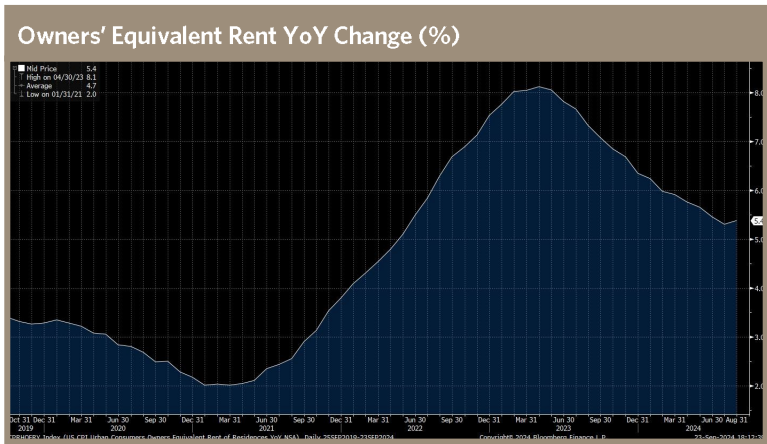
On the next page is a 5y chart showing CPI year-over-year percentage changes. Headline CPI (green) is at 2.5%, Core CPI (blue), which excludes food and energy, is at 3.2%, Core Goods (red) is -1.9%, and Core Services (purple) is at 4.9%.

On the positive side: we are seeing deflation in goods, and headline CPI has come all the way down to 2.5% from its peak in June 2022. On the negative side: Core CPI is still quite high at 3.2% and Core Services is extremely high at 4.9%. Our concern: What happens when the deflation in core goods subsides? We currently have high service inflation offset by goods deflation. If service inflation stays sticky and goods stop falling, then we are not going to be anywhere near target policy rate.

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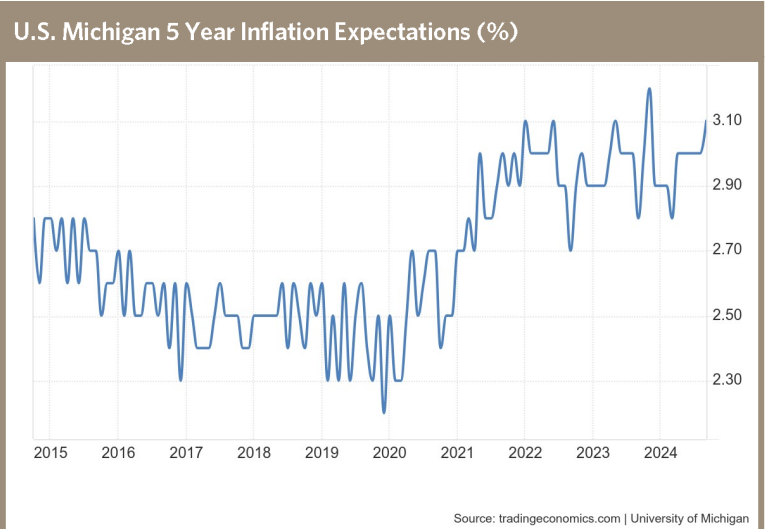
Now, why is core service inflation so high? Housing. In the CPI Index, housing is referred to as OER (owner's equivalent rent), which makes up about **25%** of the index weight. The chart below shows the OER YoY percent change, and the most recent uptick doesn't give a lot of confidence that we have conquered OER inflation.



At this point it's important to remember that the Fed actually uses the PCE Index as its inflation benchmark of choice, and this index only has a **15%** weighting to housing vs the higher weighting in the CPI index. That's one reason why core PCE figures look more encouraging than core CPI. However, even the PCE charts look like they are leveling off above target.

There was strong disinflation in 2023, but little progress has been made in 2024. Powell has repeatedly said that inflation expectations are well anchored, but when looking at UMich 5-Year inflation expectations, it looks like they are actually anchoring at a level much higher than pre-Covid times, and at a level that is above the Fed's target.

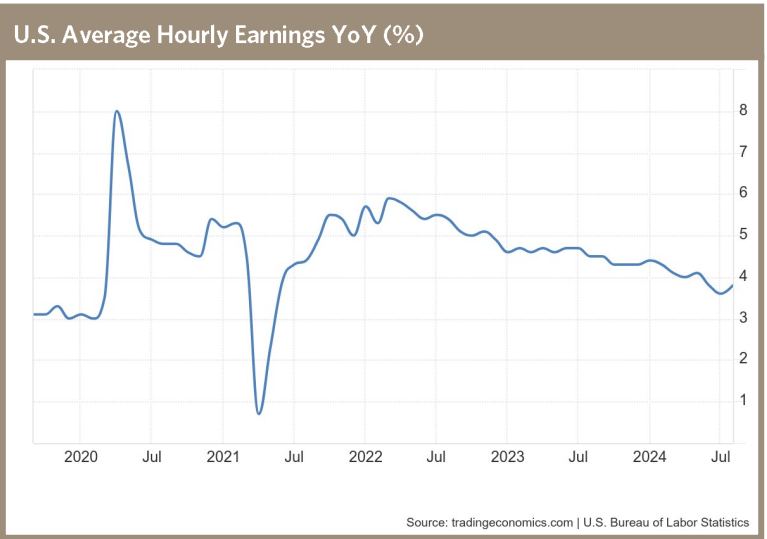
Lastly, we would point to wages. In his last press conference Powell himself conceded:



"Wages are still a bit above what would be consistent with two percent inflation."

He went on to say that they are "coming down to what that level is."

This is the same kind of thinking that produced the Powell pivot back in 2023 only to see him have to reverse course, but the plethora of weakening labor data is likely giving the Fed confidence that wage pressures will not be an inflationary issue.



On a more positive note, when we take a step back and simply look at money supply as measured by M2 (chart on next page), we can see how extreme the growth was from the Covid period through the start of 2022. Inflation appears to have peaked shortly after in the summer of 2022. Assuming a more constant rate of money supply going forward, it would be hard to see any real fearful resurgence of inflation.

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US Money Supply M2 (USD Billions)



As of the time of this writing, U.S. 10-year rates are hovering around 3.75%. If the current low in the policy rate is around 3%, and you apply some type of term premium, then 10's at 3.75% does not appear to be an attractive long. Put it together (10 year at fair value + very tight credit spreads), and owning HY or IG bonds at these levels doesn't represent much in terms of appreciation; rather, it's a carry trade from here in our view.

What would drive credit spreads tighter? They could grind lower if the weakness in the labor market subsided and growth/recession fears further abated. But in this scenario it would be plausible for interest rates to move higher, offsetting the credit spread tightening.

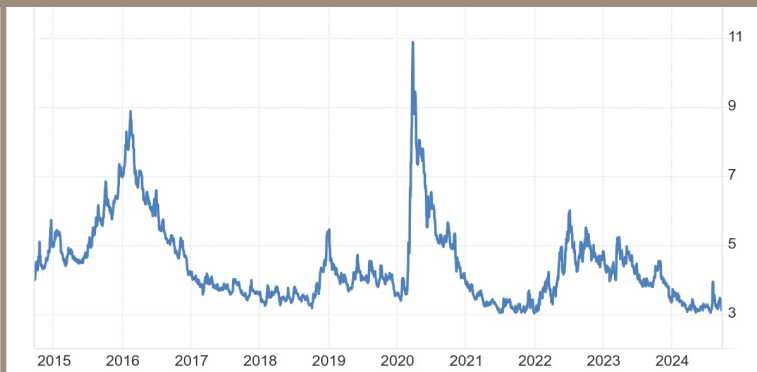
On the other hand, if interest rates were to move lower from here, that would likely come on the back of increased weakness in labor and growth, which should send credit spreads wider. It's this relationship that leads us to believe that credit is not a good long here.

Markets

In the market section of this issue we wanted to briefly touch on HY and IG bonds and spreads, as we think there is an interesting opportunity in being short corporates here. Looking at 10y charts of HY and IG spreads it is clear we are at or very near the tight in spread.

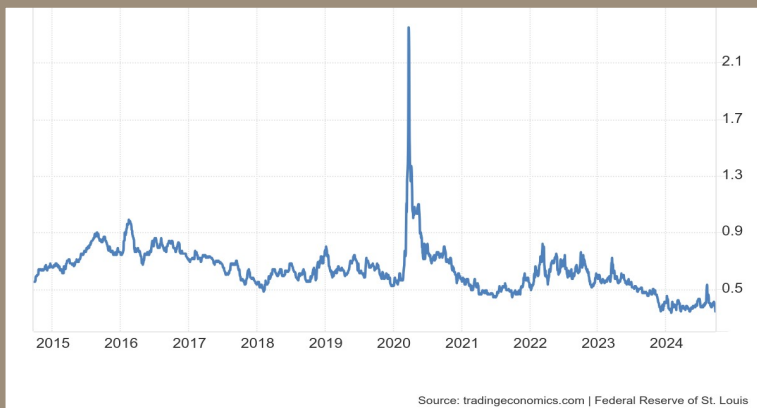
One could certainly take the other side of this view and contend that corporates will earn their carry, given that rates can protect credit spreads widening in a risk-off move—but given the nearly 100bp rally we have already experienced in interest rates over the past 6 months, we think the trade is skewed to being short corporates.

US High Yield Index Option-Adjusted Spread (%)

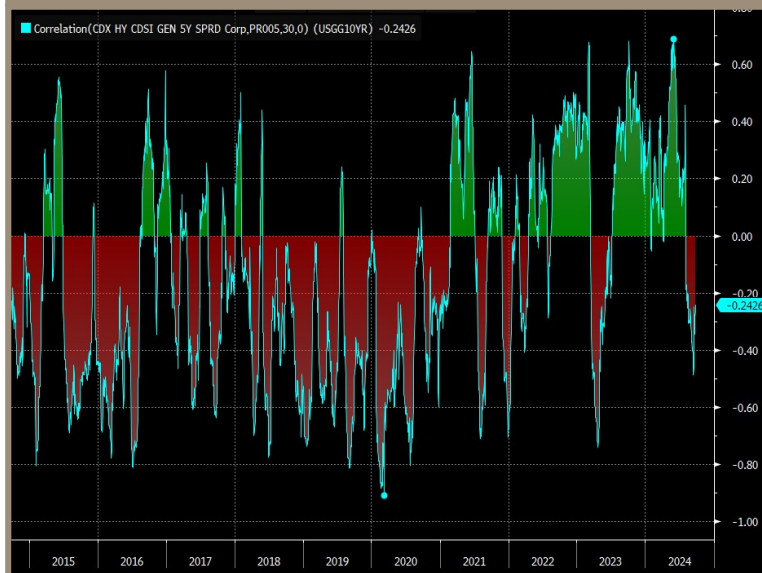


When examining this relationship it's also important to keep in mind the correlation between rates and risk, and what regime we are in. Below is a 30-day rolling correlation between HY credit spreads and 10y interest rates. The chart shows how in contrast to the past year, we are entering a period where rates and credit spreads are moving inversely, which lends further credence to the argument that a continued move lower in rates would be interpreted as a negative for credit risk (e.g. hard landing).

AAA US Corporate Index Option-Adjusted Spread (%)



30-Day Correlation — HY to S&P 500





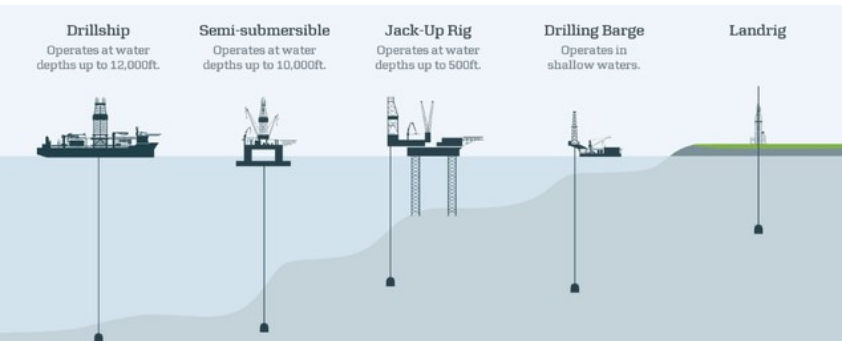
STOCK DEEP-DIVE - 2024, Issue 2

Borr Drilling: Tight rig supply heralds a virtuous cycle for the youngest jack-up fleet on the market

- High utilization amid a relative absence of newly built rigs has led to a prolonged increase in jack-up day rates
- Borr has already contracted +73% of 2025's capacity, significantly de-risking future cash flows
- As Borr's bottom line reaches an inflection point, the company is poised to reduce debt and increase shareholder returns in the form of increased dividends and buybacks

Company background and industry overview

Borr operates as an offshore drilling contractor for the oil and gas industry worldwide. They exclusively own and operate 24 jack-up drilling rigs which drill in shallower depths (up to 500 feet) as opposed to their deep-water drillship cousins which operate up to 12,000 feet.



The exploration and production companies which own the rights to the underlying offshore wells (e.g. Exxon, Shell, Saudi Aramco, etc.) contract rigs from firms like Borr at a negotiated day rate which reflects the underlying market supply and demand for these services. Borr in turn bears the cost of operating the rigs during the contracted period, and whatever is left over is the company's gross profit.

According to Borr, shallow water represents ~66% of offshore production and is second only to the onshore Middle East in terms of breakeven oil prices in the low \$20s. Shallow water also benefits from a <1 year time to production versus longer cycle deep water.

Day rates are in an up cycle

The offshore services market's latest cyclical upswing began following the 2020 crash in oil prices which briefly saw the front month futures contracts trade negative (see next page for chart of historical jack-up day rates).

The subsequent rebound lent confidence to oil production companies and led to a resumption of offshore demand. Borr's contracts announced during 2024 have carried an average day rate of \$184k/day.

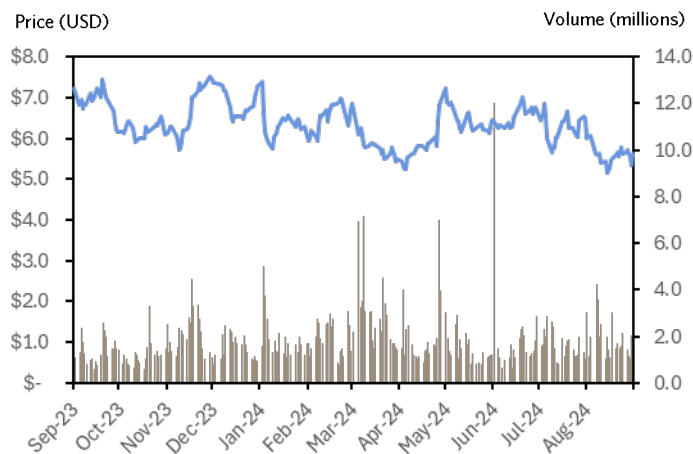
Financial Summary

Name:	Borr Drilling Limited
Ticker:	BORR
Industry:	Energy
Sector:	Oil & Gas Drilling
Price (9/27/24):	\$5.62
Market Cap:	\$1.4B
Enterprise Value:	\$3.0B
Dividend Yield:	7.1%

	2023A	2024E	2025E
Revenue	\$772M	\$1,011M	\$1,155
EV/Revenue	3.9x	3.0x	2.6x
Adj. EBITDA	\$350M	\$515M	\$620M
EV/EBITDA	8.6x	5.9x	4.9x

EPS	2023A	2024E	2025E
Q1	\$(0.03)A	\$0.06A	n.a.
Q2	\$0.00A	\$0.12A	n.a.
Q3	\$0.00A	\$0.15E	n.a.
Q4	\$0.10A	\$0.11E	n.a.
FY	\$0.07A	\$0.44E	\$0.72E
P/E	80.3x	12.8x	7.8x

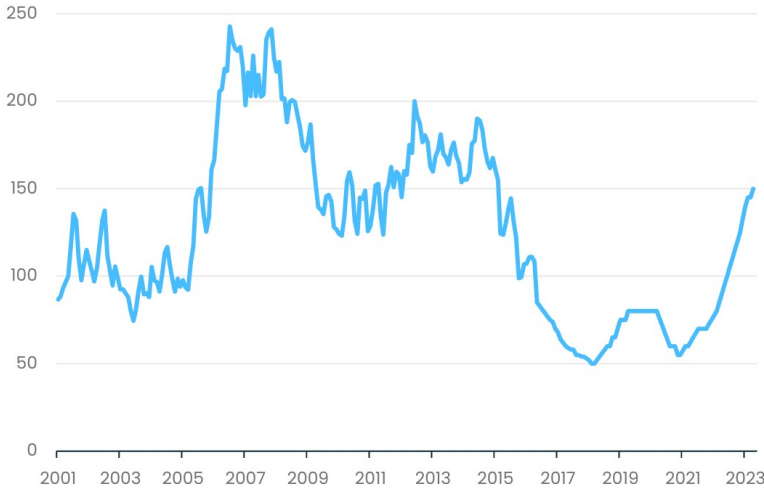
Share Price Performance





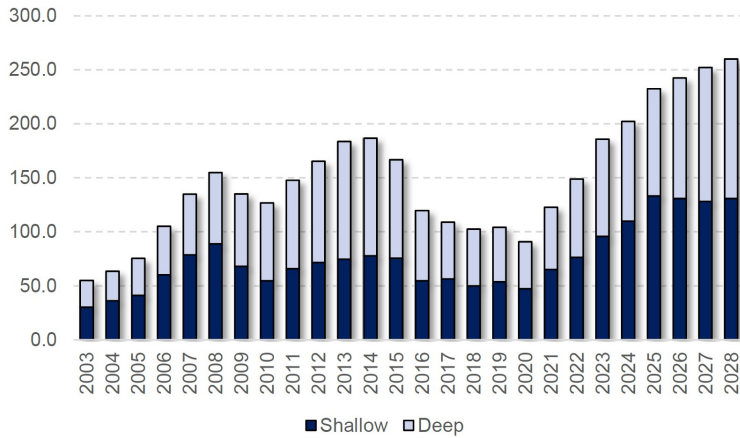
STOCK DEEP-DIVE - 2024, Issue 2

Modern Jack-up Day Rates (\$/d) - Source: Petrodata by S&P Global, DNB Markets



On the demand side, offshore capex is expected to remain robust, with growth primarily driven by Latin America, Asia-Pacific, and the Middle East. S&P Global projects that shallow water E&P capex is likely to peak in 2025, then remain consistent through 2028.

Offshore Capital Spending, 2003-2028E



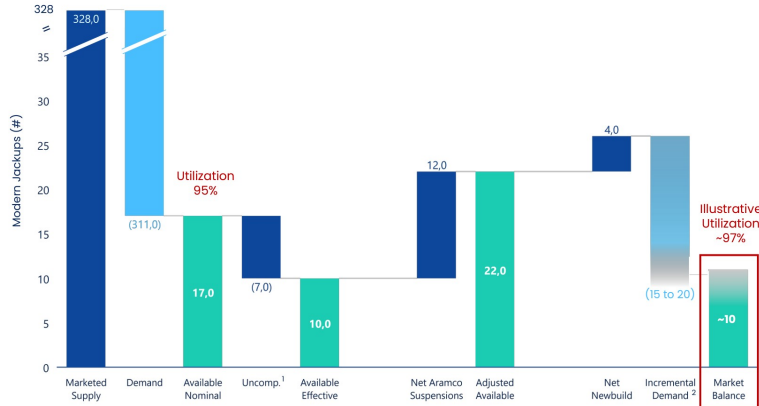
Source: S&P Global, Evercore ISI Research

But it is the supply side of the equation which paints a particularly bullish landscape for Borr. By Borr's estimates, of the net 337 jack-up rigs within the global market today, only 10 are currently available, representing a utilization rate of 97% across the industry.

Normally the supply-side would respond to such a high level of utilization through an increase in newbuilds, as was witnessed in previous cycles. Indeed, the industry experienced a speculative surge in newbuilds during the last cycle just as the tide turned and many offshore services firms went bankrupt, stranding shipyards with unpaid bills and incomplete rigs. This

has left both offshore firms and shipyards with little appetite to support newbuild capex. We would likely need to see sustainably higher day rates from here to justify such an expansion in newbuild supply, which would also take years to come to market.

Illustrative Jack-up Supply and Utilization

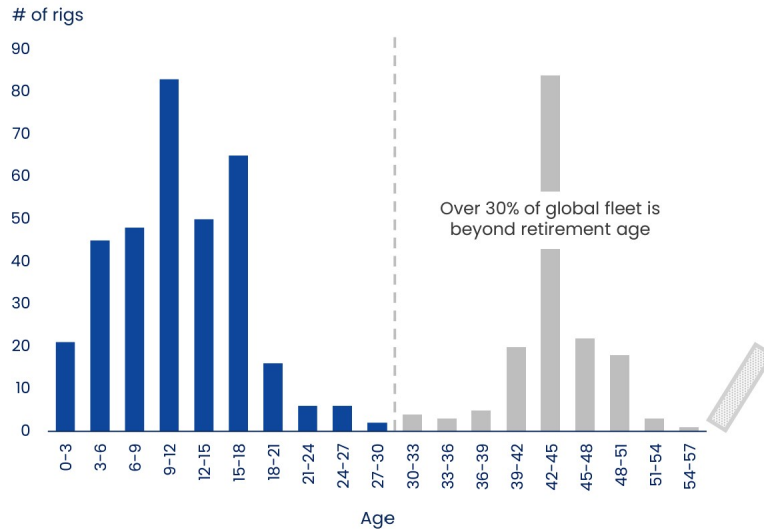


Source: Petrodata by S&P Global as on 12 Aug 2024, Fearnley Offshore and Company data
 1 Uncompetitive are units stacked for over 3 years, affected by sanctions or geographically stranded
 2 Incremental Demand: 12 to 18 months outlook based on company data considering customer open tender, market surveys and indications
 3 Aramco suspension based on announced and anticipated suspension
 4 Newbuilds data based on Fearnley Offshore projected number of 3 to 5 newbuild rigs expected to reach the market within 18-24 months

Borr further benefits from a second tailwind on the supply side. They have the youngest fleet of jack-ups across the industry at an average age of just seven years. This further increases demand for Borr's fleet, allowing them to charge premium day rates while also having a relatively smaller amount of maintenance capex requirements.

This age advantage is further magnified by the fact that +30% of jack-ups on the market are now past the traditional retirement age of 30 years, further exacerbating the supply-side tightness within the market.

Age of Global Jack-up Rigs - Source: Borr Drilling





STOCK DEEP-DIVE - 2024, Issue 2

Earnings are inflecting higher

2023 was Borr's first year to achieve a marginally positive net income (the company was only formed in 2016). And with contracts continuously rolling to higher day rates, Borr's earnings should only continue to inflect higher from here.

Management is guiding to a midpoint of \$525mm in EBITDA for 2024 with an average day rate of \$135k/day. Turning to 2025, 73% of the year's capacity is currently contracted at an average day rate of \$148k/day with some recent contracts witnessing rates of ~\$200k/day.

Borr estimates that decreased capex (they have recently completed two newly built rigs) and increased day rates should result in an additional \$200mm in free cash flow for FY 2025. Combining this with Borr's ~\$100mm in current annual dividends comes to \$300mm in cash flow which could be available for return to shareholders through either dividends or share buybacks. This alone would represent roughly 20% in potential shareholder returns vs current market cap for FY 2025, which would only go higher in 2026 if current day rates persist.

The Saudi shake-up

The offshore services market experienced a bout of uncertainty earlier in the year when Saudi Aramco elected to suspend drilling on several offshore projects as the company looked to curtail spending and production.

Share prices for offshore firms dramatically sold off as there was a fear that supply of rigs would spike, day rates would come down, and near-term revenues would be impacted by the rig cancellations. Borr itself announced the suspension of one Aramco rig on April 4, 2024.

But the Aramco move did not prove to be the disaster that many had feared. Less than four months later, Borr announced that they had re-contracted the rig which was released by Aramco at **a day rate which was 60% higher than the rate on the Aramco contract for a four-year term**. Thus far the market appears to be absorbing the Aramco suspensions in stride.

Borr price objective

Borr currently trades at ~5.4x estimated NTM EBITDA (average sell-side estimate being ~\$555mm). This is a discount to the industry average of 7.0x.

As Borr's cash flow inflects higher along with increased dividends and share buybacks, we would expect the multiple to re-rate higher to ~6.5x EBITDA under a base case scenario. This would imply a price target of ~\$9.50 per share based on the sell-side's estimated 2026 EBITDA of \$620mm, representing 76% in upside after dividends.

Put another way, Borr's 2025 P&L is significantly de-risked and has a relatively large degree of clarity. If they do indeed allocate the equivalent of ~20% worth of today's market cap toward shareholder returns through a

combination of dividends or share buybacks, this would represent such an extraordinarily large yield / volume of shares that it would be very difficult envisioning the share price not reacting accordingly.

Risks

To state the obvious, Borr is exposed to the price of oil. Lower oil prices could lead to the curtailment of offshore production projects and result in lower future day rates and/or lower utilization.

A second risk is the possibility of additional newbuilds which would increase jack-up rig supplies; however, we have touched on why this is not a likely outcome unless day rates continue to move higher from here (a good problem to have).

Borr operates across the globe and is exposed to various geopolitical risks which may disrupt operations.

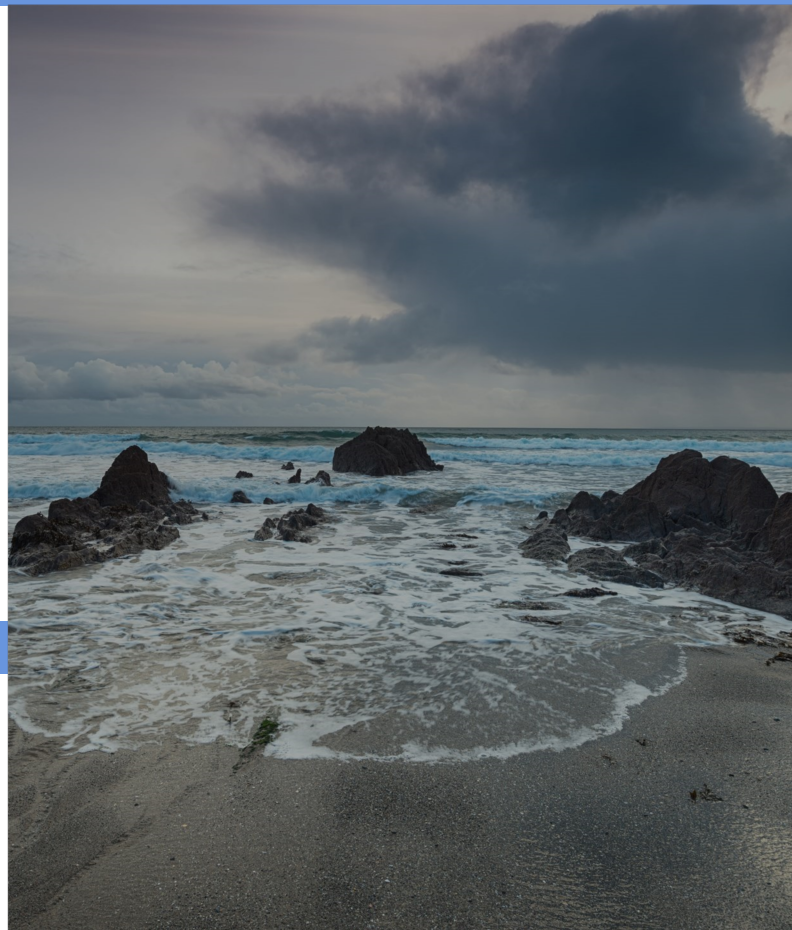
And lastly, while management has not given any indication that they are interested in M&A, there is always a risk that management teams pursue M&A growth in lieu of shareholder returns.



ABOUT FLOOD TIDE CAPITAL MANAGEMENT

Flood Tide Capital Management was founded in 2024 by William Hyde and Matt Rouse. We follow an opportunistic equities strategy which employs a top-down oriented perspective to identify core themes, from which industry and company specific fundamental analysis is then deployed to identify targeted investment candidates on an ongoing basis. This approach capitalizes on the unique experience and skillsets brought to the table by our co-founders.

Inspiration for the Flood Tide name came from William Shakespeare's Julius Caesar: "There is a tide in the affairs of men, which, taken at the flood, leads on to fortune". This line neatly encapsulates a key component of our investing philosophy: **market opportunities exhibit ebbs and flows between favorable and hazardous conditions, and it is up to the skilled navigator to guide the path to fortune.**



CONTACT



info@floottidecm.com



floottidecm.com

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