February 28, 2007

Value Investor INSIGHT

The Leading Authority on Value Investing

Industrial Strength

The trick in managing a concentrated portfolio is finding one's share of big winners while avoiding losers. Alex Roepers has proven quite adept at doing both.

While his fellow Harvard MBAs scrambled for consulting and finance jobs in 1984, Alex Roepers joined industrial conglomerate Thyssen-Bornemisza Group. "My family was in the printing business for nearly a century and I've always had an affinity for companies that actually make things," he says.

This affinity has paid off nicely for Roepers' investors. His Atlantic Investment Management now manages $4.5 billion and its core long/short U.S. equity fund has returned a net 17.5% annually over the past 10 years, vs. 7.9% for the S&P 500.

Targeting a compact universe of industrial companies around the world, Roepers is finding opportunity today in such diverse areas as aerospace and defense systems, mining equipment and printing. See page 2

INVESTOR INSIGHT

Alexander J. Roepers
Atlantic Investment Management, Inc.

Investment Focus: Seeks companies with predictable, sustainable franchises that have hit self-inflicted or market "speed bumps" he believes are temporary.

Hitting for Average

Whether in distressed industrials or high-quality tech stocks, Pennant Capital's Alan Fournier excels at identifying future potential the market is missing.

INVESTOR INSIGHT

Alan Fournier
Pennant Capital

Investment Focus: Seeks companies for which recent performance or events have caused the market to underestimate or misprice normal earnings power.

After six years as the equity-focused partner at Appaloosa Management, Alan Fournier was shown the door by founder David Tepper in late 2000. "In a good way," says Fournier, "He said it was time for me to do my own thing."

As befits his record as a money manager, Tepper's judgment was impeccable. Fournier's Pennant Capital now manages more than $1.4 billion and its flagship fund since the beginning of 2001 has returned an average annual 19.4%, net of fees, vs. 3.1% for the S&P 500.

Placing "asymmetric" bets for which he considers the upside potential to be at least three times the downside risk, Fournier is finding opportunity today in a wide variety of industries, including pharmaceuticals, mortgage lending and coal. See page 11

Inside this Issue

FEATURES

Investor Insight: Alex Roepers
Betting on industrial stalwarts such as Joy Global, Goodrich, TNT, R.R. Donnelley and Rheinmetall. PAGE 1 »

Investor Insight: Alan Fournier
Placing favorable odds on prospects for TransDigm, PHH, Axcan Pharma and Walter Industries. PAGE 1 »

Uncovering Value: SuperInvestors
What less-heralded names are catching smart investors' attention? PAGE 19 »

A Fresh Look: Capital One
Why Tom Brown's enthusiasm for the company is undimmed. PAGE 20 »

Of Sound Mind: Managing Risk
The safety checks premier investors apply to their portfolios. PAGE 21 »

Editors' Letter
A perfect sign that the market's complacency was due for a jolt. PAGE 22 »

INVESTMENT HIGHLIGHTS

INVESTMENT SNAPSHOTS	PAGE
Axcan Pharma	16
Capital One	20
Goodrich	5
Joy Global	4
PHH	15
R.R. Donnelley	7
Rheinmetall	8
TNT N.V.	9
TransDigm	14
Walter Industries	17

Other companies in this issue:
Baidu.com, Ball Corp., BearingPoint, Black & Decker, Dai Nippon Printing, Dana, Delphi, Embarq, Ligand, Nasdaq, New York Times, Sherwin-Williams, Sonoco Products, Symantec, Take-Two Interactive, Wyndham Worldwide, Wynn Resorts

Investor Insight: Alexander Roepers

Alexander Roepers of Atlantic Investment Management describes why companies in so many industries never make it onto his buy lists, how good ideas tend to fall in his lap, his particular brand of shareholder activism and what he thinks the market is missing in Joy Global, Goodrich, R.R. Donnelley, TNT N.V. and Rheinmetall.

Since you started out in the business you've focused on quite a narrow investment universe. Why?

Alexander Roepers: I realized early on from watching people like Warren Buffett and some of the early private-equity players that if I was going to stand out, I needed to concentrate on my highest-conviction ideas, in a well-defined set of companies that I knew very well. As a result, I limit my universe inside and outside the U.S. in a variety of ways. I want liquidity, so I don't look at anything below $1 billion in market cap. I want to have direct contact with management and to be a top-ten shareholder in my core holdings, so anything above a $20 billion market cap is out.

Because five or six unique holdings make up 60-70% of each of my portfolios, I also exclude companies with idiosyncratic risk profiles that I consider unacceptable in such a concentrated portfolio. That means I exclude high-tech and biotech companies with technological-obsolescence risk, tobacco or pharmaceutical companies with big product-liability risks, utilities and other regulated companies where the government can change the rules of the game, and companies that lack sufficient transparency, like banks, brokerages and insurance companies.

Then we boil it down further into potential "core" longs and "other" longs. Core longs are those in which we can own 2-7% of the company and have a close, constructive relationship with management. Overall, the potential universe of core holdings has around 170 companies in the U.S. and about 180 outside the U.S. These are the stocks that drive our performance – we've made our record by finding our share of big winners among these core longs while avoiding almost any losers. Our most-concentrated U.S. fund, which holds only five or six stocks, has had only one losing investment since we started it more than 14 years ago.

Describe the types of companies that do make the cut.

AR: They're typically industrial products and services companies, like defense suppliers, packaging firms and diversified industrials. We favor companies with transparent businesses that we can understand fairly quickly and those that have large and recurring maintenance, repair and overhaul revenues from an installed base, such as elevator companies or aerospace-parts firms.

We require strong balance sheets and a long record of profitability, so we're not usually investing in classic turnarounds. The stocks are cheap because they've hit a speed bump of some kind – from a messed-up factory changeover, an unusual competitive pricing issue or maybe some kind of commodity pricing pressure – but we think we can understand the problems and anticipate that the issues are solvable or going away.

We also put a lot of emphasis on the sustainability and predictability of the business. Our companies tend to be in industries that have consolidated, with only two, three or four leading players. For example, we've owned Ball Corporation [BLL], the packaging company, as a core long four times over the past 14 years. Ball's customers require a global scale that only a very few companies can have and, if a competitor doesn't have it, it's likely to go away. We can't take that type of risk in a concentrated portfolio.

How do you generate specific ideas?

AR: With a narrowly defined universe, the ideas typically just fall in our lap. We have what we call a signal system, which

Alexander J. Roepers

Smoother Sailing

His cosmopolitan background counted for little when Alex Roepers came to the U.S. from the Netherlands in 1980 to work for electronics firm Universal Instruments. "I'm fairly certain I was the only person living in Binghamton, N.Y. at the time who could speak four languages," he says.

After earning an M.B.A. from Harvard in 1984, Roepers landed a corporate development job in New York with privately held Thyssen-Bornemisza Group. The European company was restructuring its portfolio of industrial businesses, with the goal of cutting by half its 80 subsidiaries in 40 industry sectors. The deal-making involved and the exposure to many industries and what it took to succeed in them, says Roepers, was an ideal experience for starting his own investment firm in 1988.

His timing, however, couldn't have been much worse, as the collapse of the junk-bond market, the savings-and-loan crisis and Iraq's invasion of Kuwait all pummeled equity prices. "It was like being in a little boat in a big storm," he says. The lessons? "There were three main ones: That I should concentrate heavily on my highest-conviction ideas, that I needed the ability to be in cash and that I needed to develop a short book."

tracks hundreds of companies against valuation metrics and historical trading levels. Our primary input is to make sure we have all the right companies in the system and then set the triggers for each company at which we think it deserves a closer look. So if a Constellation Brands [STZ], for example, falls 10% in a day as it did last month, we'll put someone on it right away. I've got an analyst reviewing the company as we speak.

I sit down three or four times a week with all of our analysts and go through the system and make to-do lists. It's my favorite and most productive time and it's a disciplined way to ensure we don't miss things.

I'll give you a good example of one of our typical investments, in Sonoco Products [SON]. Sonoco is a 108-year-old company in South Carolina that makes industrial and consumer packaging, such as composite-paper cans for Pringles or flexible packaging for Gillette shavers or Oreo cookies. I had watched the company for 10 years and the fabric of the business is just what we look for: it has never lost money, has paid quarterly dividends since 1925, has 250 facilities around the world and has no major technological-obsolescence risk. The problem was that it was never cheap enough, until about four years ago when they had problems in some of their more cyclical businesses and had pension fund losses that hit earnings. The stock fell by a third, the dividend yield got to 4% and we started buying around $20.

It may be a boring business, but they were well-positioned, continued to execute very well and the temporary problems got better. On top of that, with some fairly strong urging on our part, they started last year buying back shares in volume with excess cash flow. As the share price recently started hitting all-time highs, we sold almost all of our position. [*Note*: Sonoco shares currently trade around $37.]

On what valuation metrics do you focus?

AR: We want to see at least a 10% free-cash-flow yield and a 6x or less multiple of enterprise value to next year's earnings before interest, taxes, depreciation and amortization [EBITDA]. For enterprise value we use the current market value plus the estimated net debt 12 months out.

Most of the companies in our universe generally live within a range of 6x to 8x EBITDA. The idea is to identify companies having some earnings or other trouble that leave them trading at the low end of the valuation range. If our analysis is right that the difficulties are temporary, we get two boosts: from earnings recovering and from the market reacting to the earnings recovering and moving the multiple to the higher end of the range. We believe that dynamic gives all our core positions a very high probability of at least a 50% return within two years.

At the end of the day we're trying to buy companies as if we were buying a $10 million office building across the street. We do our homework on the tenants and the leases in place and make sure it's financed in a way that produces a 10% free-cash-flow yield. The idea is to increase equity by paying down debt with the free cash flow and also to benefit from the asset appreciating over time. With stocks, if you focus on companies with around 10% free cash flow yields and highly predictable, sustainable franchises, you protect your downside and set yourself up for nice capital appreciation.

What kind of a sell discipline do you typically follow?

AR: We try to keep it fairly rigid. When a holding hits some combination of 8x EBITDA, 12x EBIT or 15x forward earnings, we're going to start selling. That means the shares are in the top end of their valuation range and we can't expect enough further upside. When Sonoco hit a 15x forward P/E there was just no further reason for us to be in the stock. Same with Black & Decker [BDK], which we also recently sold after a good run. Not only did the valuation get relatively high, but we became increasingly concerned about the company's exposure to a housing market that is likely to be troublesome for some time.

ON ACTIVISM:

We have 10-15% of our capital in each of our core companies, so I just think it's imperative we make our views clear.

Central to your strategy is to have position sizes that ensure an active dialogue with management. Why?

AR: Being an activist has taken on a bit of a negative connotation in the past few years, but we absolutely want to be constructively-engaged shareholders. We have 10-15% of our capital in each of our core companies, so I just think it's imperative that we make our views, particularly with respect to capital allocation, clear. For the most part, management appreciates the faith we're placing in their business and in them to get the stock out of the valuation hole it's in.

And when they don't appreciate it?

AR: When management is unresponsive, we work to change that. We've had a successful investment in Schindler, the elevator company based in Switzerland. But when I first called to arrange a meeting with Mr. Schindler after becoming the third-largest shareholder, I was told that he doesn't meet with shareholders. I suggested that Mr. Schindler could instead arrange a meeting with his bankers about taking the company private, so he could maintain that attitude. We eventually met for 2 1/2 hours and now have a good relationship.

I don't like proxy battles, I just want to make money and maintain my liquidity. The moment you force yourself on a board, you become illiquid. We do get frustrated from time to time, as a result of management inaction or when we don't think it's acting in shareholders' interest.

With Dole Food, for example, it appeared to us that the chairman in 2002 was taking actions that held back the share price and then he subsequently tried to buy the company for a paltry premium. We were the second-largest shareholder and called him on it publicly and he eventually had to pay substantially more. That's a rare scuffle; we generally try to operate more behind the scenes.

More than half your assets are invested outside the U.S. Do you do anything differently when investing internationally?

AR: Not at all. We define our universe in the same way in each major developed market. In doing that, of course, some markets offer more opportunity than others. In Taiwan, after excluding tech and banks, there's little left for us to invest in. There are only five to ten companies each for us in markets like South Korea and Hong Kong. The real opportunities for us are in Japan, the U.K. and continental European countries like Germany, Holland, France, Sweden, Norway and Switzerland.

Japan is particularly interesting right now. It's a bit of a two-headed dragon, with both quite overvalued and quite undervalued stocks in our universe. You've got interesting companies like Dai Nippon Printing trading at extremely low multiples, while other companies in our universe trade at 12-15x EV/EBITDA multiples. While corporate governance is improving in the developed countries, Japan is probably still the furthest behind. Some of the best opportunities today, though, are in companies that have a long way to go in improving corporate governance.

Tell us why you've made Joy Global [JOYG] a core holding.

AR: Joy is the leading maker of high-productivity above- and below-ground mining equipment in the world and is in an extremely strong competitive position. Customers in most cases have only two legitimate choices for this kind of equipment, and depending on the specific product, Joy can have 50-90% market share worldwide. Given how big Joy's market share is and its long track record of service and reliability, it would be very difficult for a new competitor to gain a foothold in this business.

Another very positive aspect of Joy's business is that 60-70% of revenues are derived from servicing and providing spare parts to its huge installed base. The equipment goes through a lot of wear and tear and there's a constant need for maintenance and replacement parts. That provides a much more stable base than you might expect to a company impacted by commodity cycles.

Speaking of commodity cycles, are you taking a position on commodity prices by owning Joy now?

AR: We believe we're in a powerful cycle for commodity prices. The mining business has tremendous backlogs right now and will for many years as expanding international markets and new applications – such as the development of oil-sands properties – drive demand. China is just one of many countries where business is booming. Joy recently hired the president of one of its largest Chinese customers to head up its operation there, which should benefit from expanding its

INVESTMENT SNAPSHOT

Joy Global
(Nasdaq: JOYG)

Business: Manufacturing and maintenance of equipment used in the mining of coal, copper, iron ore, oil sands, precious metals and other minerals worldwide.

Share Information
(@2/27/07):

Price	50.33
52-Week Range	31.32 – 72.23
Dividend Yield	1.1%
Market Cap	$5.70 billion

Financials (TTM):

Revenue	$2.40 billion
Operating Profit Margin	18.4%
Net Profit Margin	17.3%

Valuation Metrics
(Current Price vs. TTM):

	JOYG	S&P 500
P/E	16.1	20.8
P/CF	13.5	15.1

Largest Institutional Owners
(@12/31/06):

Company	% Owned
Wellington Mgmt	8.5%
Neuberger Berman	7.3%
Fidelity Mgmt & Research	6.9%
T. Rowe Price	4.8%
Earnest Partners	3.9%

Short Interest (@ 1/9/07):

Shares Short/Float	3.5%

JOYG PRICE HISTORY

THE BOTTOM LINE

A powerful long-term commodity cycle should drive continued strong demand for the company's mining equipment, says Alex Roepers, which creates additional high-profit revenue from providing service and spare parts. At the high end of the stock's traditional EBIT-multiple range, he believes the shares could reach $73 within two years.

Sources: Company reports, other publicly available information

current 20-30% share of a growing market for high-productivity equipment.

We're not taking the full commodity-pricing risk you'd have by investing in an oil company or a copper company, but as long as commodity producers continue to expand capacity – and we believe they will – Joy benefits. It's a virtuous cycle: as they deliver new equipment, it creates an additional revenue stream from future service and spare parts. Joy's surface-mining business did about $400 million in revenues in 2002 and is likely to reach $1.4 billion in 2008. Of that $1.4 billion, roughly $900 million will come from aftermarket sales.

With the shares trading recently at just over $50, what upside do you see?

AR: With strong end-market demand, good aftermarket sales and excellent cash flow being used to reduce share count, we expect earnings per share to grow 15% per year over the next few years.

For valuation purposes, we focus here on multiples of EBIT, which for Joy have tended to be in a range of 8x on the low end and 12x and above on the high end – a reasonable range that's actually below many industrial companies. At 8x our estimate of fiscal 2008 EBIT, the share-price downside is around $44, while at 12x you'd have a potential share price of $64. That's an attractive risk/reward over the next 12 months or so. If you look one year further out – which we're comfortable doing given the visibility into the cycle – we see the high-end of the multiple range resulting in a price of $73.

What's the biggest risk?

AR: Probably the sentiment risk tied to commodity pricing. The stock got way overvalued in May of last year and then cratered from $70 down to $33 as prices for commodities fell. If copper dropped another 20-30%, it wouldn't help the stock from a sentiment perspective. But even that kind of drop wouldn't change the copper mines' current plans for adding capacity, and as I said, we see the price trends working in our favor over time.

Describe your interest in aerospace company Goodrich [GR].

AR: I should say upfront that this company does not make tires. It's a tier-1 aerospace component and subsystem supplier with an extraordinarily strong position in terms of its installed base, technology and manufacturing know-how. It's one of the two or three go-to players for manufacturers of commercial, regional and private aircraft, which account for roughly two-thirds of revenues. The other one-third is in serving the defense industry.

As with Joy, this is another case where the aftermarket business – currently 35% of total revenues – is very profitable and predictable. It's highly unlikely that the owner of an aircraft would take on the additional liability of sticking a cheaper replacement part into a landing-gear system made by Goodrich. Companies like Pratt & Whitney are trying to build that type of third-party business, but we think it's very unlikely to will have a meaningful impact on Goodrich.

Is this partly a bet on the commercial-aerospace cycle remaining strong?

AR: Yes. Airbus and Boeing are fully booked looking out to the end of the

INVESTMENT SNAPSHOT

Goodrich Corp.
(NYSE: GR)

Business: Global supplier of components, systems and services used in the manufacture of aircraft for commercial, general aviation, military and space markets.

Share Information
(@2/27/07):

Price	**48.79**
52-Week Range	37.15 – 52.00
Dividend Yield	1.6%
Market Cap	$6.12 billion

Financials (TTM):

Revenue	$5.88 billion
Operating Profit Margin	11.0%
Net Profit Margin	8.2%

Valuation Metrics
(Current Price vs. TTM):

	GR	S&P 500
P/E	13.3	20.8
P/CF	8.8	15.1

Largest Institutional Owners
(@12/31/06):

Company	% Owned
Wellington Mgmt	11.1%
Cramer Rosenthal McGlynn	3.5%
Atlantic Inv Mgmt	3.2%
Barclays Global Inv	3.0%
Atalanta/Sosnoff Capital	2.6%

Short Interest (@ 1/9/07):

Shares Short/Float	1.8%

THE BOTTOM LINE

A long-lasting manufacturing cycle for commercial and military aircraft, strong aftermarket sales and improving operating margins should result in EPS "north of $4" by 2009, says Alex Roepers. Applying the multiple GE recently paid for a comparable aerospace business to that number, he says, results in a share price closer to $80.

Sources: Company reports, other publicly available information

decade, with most of the backlog coming from growth areas like India, China, Eastern Europe and the Middle East. At the same time, the average life of a commercial jet is around 25 years and legacy airlines like American and Luftansa are by and large sitting on fleets with planes that are 15-17 years old. That makes it highly likely that legacy carriers will be making additional, multi-billion-dollar orders for deliveries out to 2015.

Overall, we think the manufacturing cycle for aircraft is solid and will last longer than previous cycles. That gives us good visibility into new-equipment sales, the most cyclical piece of Goodrich's business, which we expect to produce 5-6% organic growth for years to come.

What about the defense business?

AR: The company has excellent positions in military platforms such as the Joint Strike Fighter, which will replace F-16s in the U.S. and will be used in air forces around the world. It will be in either the Boeing or Airbus platform for refueling tankers, which should be a 20-year program. In general, I think the secular trends for Goodrich's defense business are positive, no matter which party is leading the government. The world is an increasingly dangerous place and the projection of air power is the number-one priority for the U.S. to maintain superpower status around the world.

The shares, recently at $48.80, have been near a 52-week high. How are you looking at valuation?

AR: Operating margins are now around 13%, up from 10% in 2003, and we think management can get them to 15% within the next couple of years as a result of scale efficiencies and a variety of cost-saving initiatives. They are also negotiating a new contract for landing gear with Boeing that should correct what has been an overly good deal for Boeing.

If you apply to 2007 estimated earnings the multiple GE paid for the aerospace business of Smiths Group of the U.K., Goodrich would trade for $60-65 per share. By 2009, we expect the company to have revenues of over $7 billion, with 15% margins and earnings per share north of $4. If you apply that private-market multiple on 2009 numbers, you'd have a share price around $80.

The company has suffered from too much debt in the past. Is that a problem today?

AR: Management learned a hard lesson from leveraging the company too much to acquire TRW's aerospace business in 2003, so I don't expect that to be a problem going forward. They've been using cash flow to pay down debt and appropriately fund their pension plan. Debt is now around $1.7 billion, resulting in annual interest expense of $120 million or so. With EBITDA in the $1 billion range, the debt is well under control.

FIRST IMPRESSIONS OF RRD:

It was run out of large, pompously designed offices and was just ripe for someone to take out a ton of overhead.

You mentioned your family used to be in the printing business. Tell us why you like printing giant R.R. Donnelley [RRD].

AR: Prior to actually owning it, I had long considered Donnelley to be an ideal LBO candidate. It was run out of large, pompously designed mahogany-paneled offices in Chicago and was just ripe for someone to come in and take out a ton of overhead. This is a very competitive, nickel-and-dime business and the last thing a printer should do is show its employees and customers that it's making a lot of money.

In late 2003, R.R. Donnelley merged with Moore Wallace, a restructured business-forms and outsourcing company, and that's when we first started buying the stock. Both companies had been top candidates for us and we saw a huge opportunity for new management to cut costs and find other operating synergies. The CEO of Moore Wallace, Mark Angelson, became CEO of the combined company. While early estimates were for around $100 million in cost savings, they achieved $300 million in the first year-and-a-half and now are closing in on annual savings of $500 million from the deal.

The company now doesn't really have a peer, given the breadth of services it offers. They are the 800-lb. gorilla in most of the areas they operate in.

Is being the 800-lb. gorilla in the printing business that attractive?

AR: The traditional printing business keeps plugging along. Donnelley currently prints about half of the best-selling books, Yellow Pages directories and magazines produced in the U.S. While you might assume all of these are threatened by the Internet, print volumes have remained quite stable. Yellow Pages directories are still a venue for local advertisers that they can't do without. While some magazines fold, others get launched.

Given the volume and quality requirements of big customers, printing is becoming a more concentrated business and being the biggest is a clear advantage. The catalog business continues to grow for them, for example, partly because it's hard for some of the larger cataloguers to get their work done anywhere else. Small printers find it harder and harder to compete for national accounts. There are only three major printers that can do the big jobs – Quad/Graphics, which is privately held, and Quebecor, which has had a lot of problems, are the other two – but we believe Donnelley is much better managed and more competitive.

To give you an example of how scale matters: Donnelley claims that 20% of the volume going through the U.S. postal system is either printed or handled by them. In Chicago we visited a gigantic distribution facility, from which magazines and catalogs are sorted by zip code and then shipped closer to their ultimate destination before being entered into the mail stream. Donnelley can do that

much more quickly and efficiently than if the items were dropped into the postal system near the printing plant. That results in cost and time savings for customers that no one in the business has the scale to match, which is an excellent competitive advantage as well as barrier to entry.

The growth area of the company is document business-process outsourcing, which now accounts for 15% of revenues and operating profit. They do things like help American Express and Barclays with new-customer sign-ups, including managing call centers in India as well as the printing of forms and follow-up materials. They'll print, assemble and send all the brochures, luggage tags and marketing materials for companies like Carnival Cruise Lines. They'll produce customized customer statements for companies like Prudential, Charles Schwab, Fidelity and others. In general, this business is growing faster than printing, is less cyclical and has higher margins.

How cheap are the shares, trading at a recent $36.10?

AR: Earnings per share have doubled since 2003, to $2.55 last year. With cost savings on recent acquisitions, the ongoing rationalization of the manufacturing and distribution infrastructure, debt reduction and share buybacks, we think EPS could be as much as $3.40 in 2008.

On an EV/EBITDA basis, the shares trade at only a 6x multiple and have a 2.7% dividend yield. For a company that has solid growth potential in a wide variety of leading businesses, sharp management, good cash flow and a strong balance sheet, we think an 8x multiple would be far more reasonable. By 2008, that would give you a potential share price of around $58.

What activist role have you played here?

AR: A year ago we proposed a $1 billion share buyback as part of our filing a 13D after our stake rose above 5%. The math was really quite compelling with the share price in the $30-35 range. Borrowing $1 billion to buy back shares would cost less than $40 million in interest after tax, but the company would save $35-38 million in dividends. So for a few million dollars, remaining shareholders would benefit when the share price reflected a 10% increase in earnings per share. The company approved a buyback plan, but didn't implement it despite a continued weak share price.

Last August there were a variety of rumors that Donnelley was in talks to do a leveraged buyout. Our concern was that any deal would get done at a level that would relinquish a lot of the embedded upside in the company to the financial buyers, while public shareholders were sitting there with a mediocre return.

We went back with a public recommendation of a $3 billion buyback. I subsequently told the CEO I wasn't obsessed with a share buyback and that I'd much rather he find accretive acquisition opportunities. But absent that, I wanted to make sure a share buyback was clearly considered as an alternative versus some sort of going-private transaction. Since then, the company has announced close to $2 billion in earnings-accretive acquisitions, giving it additional operating and financial leverage.

INVESTMENT SNAPSHOT

R.R. Donnelley
(NYSE: RRD)

Business: Largest commercial printer in North America, with ancillary businesses providing a wide range of document-based corporate outsourcing services.

Share Information
(@2/27/07):

Price	**36.10**
52-Week Range	28.50 – 38.71
Dividend Yield	2.7%
Market Cap	$7.83 billion

Financials (TTM):

Revenue	$9.24 billion
Operating Profit Margin	10.3%
Net Profit Margin	2.6%

Valuation Metrics
(Current Price vs. TTM):

	RRD	S&P 500
P/E	51.2	20.8
P/CF	13.4	15.1

Largest Institutional Owners
(@12/31/06):

Company	% Owned
Capital Research and Mgmt	10.7%
Allianz Global Inv	5.7%
Lord Abbett	5.5%
Atlantic Inv Mgmt	5.2%
Barclays Global Inv	4.5%

Short Interest (@ 1/9/07):

Shares Short/Float	1.6%

RRD PRICE HISTORY

THE BOTTOM LINE

A vibrant business-outsourcing division and continued scale benefits from being the "800 lb. gorilla" in printing, says Alex Roepers, have helped the company double EPS since 2003. At the 8x EBITDA multiple, on an enterprise-value basis, that he believes the shares deserve, they would trade based on his 2008 estimates at $58.

Sources: Company reports, other publicly available information

Let's talk about some international ideas, starting with Germany's Rheinmetall [RHM.DE].

AR: Rheinmetall is a world-class manufacturer operating primarily in two markets, automotive and defense. The automotive business accounts for about 55% of sales, providing things like aluminum engines, pistons and bearings. They have a diversified and global customer base, but with some weighting toward the German carmakers, which are generally doing quite well.

The more interesting part of the story, however, is defense. The company is highly regarded for its technology and manufacturing capability, which positions it well to take more than its share of a growing overall pie. They have an outstanding order book, as the unfortunate state of the world's geopolitics have driven defense-spending increases and countries are looking for more European sourcing in the air defense, ammunition, electronics and land-system segments in which Rheinmetall competes.

The orders are quite broad-based. They have a new €3 billion contract with a partner to make the new German light tank, the Puma, which will go into full production starting next year and will almost double the company's land-system business. They have received substantial air-defense and ammunition orders from Greece, Turkey, Kuwait and Saudi Arabia. They're selling troop carriers to the Dutch and the Norwegians.

The company has also made and will continue to make strategic acquisitions outside of Germany, to add both product capability and to make further inroads in new markets. If you look out a couple of years, defense will eclipse automotive in size, which will have a positive revaluation effect on the stock.

Does it make sense for the two businesses to stay together?

AR: For now, yes. There are real benefits of shared overhead and we also believe there's still a lot of growth and recovery in automotive that we'd like to see realized first. The automotive business has in the past earned €150 million before interest and taxes, but last year that number was likely closer to €100 million because of higher raw materials costs and some one-time charges. As the cost increases are passed through and the charges go away, we expect the automotive unit's earnings to return to the €150-160 million level within the next one or two years.

We have a lot of confidence in management. This is an example of a German company that is actually doing all the right things with respect to corporate governance. The founding family sold its 40% stake in a very orderly fashion in late 2004 and did away with two share classes shortly thereafter, broadening the share ownership in a way that has helped the share performance. We'd like to see more of this type of behavior elsewhere, particularly in Japan.

At a recent €61.50, how attractive are the shares?

AR: If some big orders come through as we believe they will, we see revenues approaching €5 billion a few years out, up from €3.7 billion this year. We expect EBIT margins of 10% in defense and, as they get things straightened out, maybe 7-8% in automotive. Given those types of margins, there's no reason the total company shouldn't then trade for at least 1x revenues. After subtracting about €500 million of debt – on only 35 million shares outstanding – we see an upside of around €115.

INVESTMENT SNAPSHOT

Rheinmetall AG
(XETRA: RHM)

Business: Global manufacturer of automotive engine components and land-forces military equipment, with 70% of revenues outside home German market.

Share Information
(@2/27/07, Exchange Rate: $1 = €0.7551):

Price	**€61.50**
52-Week Range	€47.01 – €68.00
Dividend Yield	1.5%
Market Cap	€2.2 billion

Financials (2006 thru September, annualized)

Revenue	€3.43 billion
Operating Profit Margin	4.3%
Net Profit Margin	2.1%

Valuation Metrics
(Current Price vs. TTM):

	RHM	DAX
P/E	19.2	14.4

RHM PRICE HISTORY

THE BOTTOM LINE

Alex Roepers doesn't believe the market is adequately recognizing either the dramatic growth in the company's broad-based defense business or the potential for its automotive business to return to prior profit levels. At even 1x the annual revenues of €5 billion he expects within the next few years, the shares would trade at around €115.

Sources: Company reports, other publicly available information

Last but not least, explain the thesis behind an idea from your native Holland, TNT N.V.

AR: TNT used to have the monopoly in mail delivery in the Netherlands, which is a €4 billion revenue business with close to 20% margins. The company has used the cash flow from that business over time to buy and then build an express-mail delivery business under the TNT name. In Europe they are the primary competitor to DHL – which is owned by Germany's Deutsche Post – with each having about 25% of the market. Overall, TNT's express business is growing about 10% per year on a revenue base of €6 billion.

While they don't always move as quickly as we'd like, management has taken some important steps to enhance shareholder value. They sold their logistics business, in which they had very few inherent competitive advantages, and instituted a large share buyback plan.

At the same time, they're knocking the cover off the ball in the express business. They're growing three times as fast as DHL in Europe, taking advantage of the expanded European Community. They're growing strongly in China, India and Southeastern Asia and just made a large acquisition in South America, almost instantly making TNT a big player there.

Is the traditional mail business a weight on the share price?

AR: It's clearly not growing like the express business, but it remains stable and can produce on the order of €750 million in EBIT every year. Whatever they lose in the Netherlands as the market opens up, they make up by expanding into other liberalized markets like Germany, Italy and the U.K. They are now the #2 mail provider in each of those countries, usually by going after large corporate contracts. In the U.K., for example, they handle most of British Telecom's direct-mail activities.

How are you valuing the shares, which closed recently at around €33?

AR: We look at the two businesses separately. There is a high probability either UPS or FedEx will try to buy TNT's express-mail business, to become the market leader in Europe. With a great brand, better than 10% margins and motivated buyers, the express business is likely worth 1.5x sales, which on 2009 numbers would be €12 billion.

The mail business is a solid cash generator that we think would be attractive to private-equity buyers. At 10x EBIT, that's worth around €7.5 billion. So on a base of around 390 million shares, after net debt of €1.5 billion, we arrive at a sum-of-the-parts value of around €46 per share.

We haven't spoken about shorting. What short themes are you pursuing today?

AR: We have a number of housing-related shorts, such as Sherwin-Williams [SHW], which also has potentially sizable liabilities as a result of lead paint litigation. This isn't necessarily a knock on the company, but is mostly a function of its valuation and our negative view on the housing market. We're short some education stocks like Apollo Group [APOL], which recently ran up. I've never been comfortable with the for-profit education stocks as longs. Earning 60% margins providing a generally poor-quality service that is financed largely by government programs just doesn't strike me as sustainable. We also actively trade some casino stocks on the short side, like Las Vegas Sands [LVS] and Wynn Resorts [WYNN], which have gone up so much on enthusiasm about expansion in Macau.

INVESTMENT SNAPSHOT

TNT N.V.
(Amsterdam: TNT)

Business: Holland-based provider of TNT-branded mail and express-delivery services with nearly 90% of revenues from Europe and countries of the former U.S.S.R.

Share Information
(@2/27/07, Exchange Rate: $1 = €0.7551):

Price	**€33.05**
52-Week Range	€26.29 – €36.19
Dividend Yield	2.2%
Market Cap	€14.00 billion

Financials (2006 thru September, annualized)

Revenue	€9.72 billion
Operating Profit Margin	12.6%
Net Profit Margin	6.6%

Valuation Metrics
(Current Price vs. TTM):

	TNT	AEX
P/E	16.9	11.7

TNT PRICE HISTORY

THE BOTTOM LINE

The European company's express mail business is a crown jewel that will likely attract motivated strategic buyers, while its traditional mail business is a solid cash generator that will likely attract financial buyers, says Alex Roepers. On a sum-of-the-parts basis, he believes the shares are worth closer to €46 per share.

Sources: Company reports, Atlantic Investment Management, other publicly available information

We were curious to see you had invested recently in the New York Times [NYT]. Isn't that a bit out of your comfort zone?

AR: This was indeed a special-situation investment, not a core position. We'd made a substantial profit in the shares years ago and when it traded down to an eight-year low in 2005, we got interested again and started buying. Our timing was bad, primarily because we underestimated the speed of the newspaper industry's decline and we overestimated the motivation on the company's part to realize shareholder value. We normally stay away from so much insider control for just that reason.

We sold late last year around $25 per share for tax reasons, but I still think the stock will eventually do well. The bullish story is centered on the tremendous franchise value of *The New York Times*, the resolution of problems at *The Boston Globe*, the increasing value of the Internet properties, the realized value from the sale of broadcasting properties and the value of their owned real estate.

Do any market environments tend to give you trouble?

AR: I'd say that when investors focus particular attention on a given sector – like technology stocks in the late 1990s or energy and commodity stocks more recently – we're unlikely to outperform. Multiples get compressed in our universe in those times, so it's tough for us to beat an index increasingly weighted by the hot sector. We've held our own over the past three years, but it hasn't been easy having no energy/commodity producers and quite a few energy/commodity consumers in our portfolio.

What's your biggest single worry about the market today?

AR: In our view, the world economy looks pretty healthy. But I do believe there's reason to worry about systemic risk that could be triggered rather easily by one type of geopolitical event or another. I think there is an unknown but possibly very large amount of leverage in the system. If there is a dislocation, we'd very much prefer to be invested as we are – without leverage, in profitable companies with strong balance sheets and attractive end markets.

We've read about your second career as an accomplished yacht racer. Tell us about that.

AR: I grew up around boats and for many years was a crew member on teams run by friends of mine. Three years ago I bought a Swan 45 and set up my own team. I just love everything about it: the team building, the mental and physical exertion when I'm on the boat, the competition. I can absolutely not think about stocks when I'm out there – that's important to do from time to time. VII

What are the world's best investors buying and selling?

New Issue Just Published on February 26, 2007

Gain insight from what superstar investors own, what they're buying and what they're selling. *Value Investor Insight* subscribers receive four quarterly issues of SuperInvestor Insight for **only $149!**

Subscribe Online »

Mail-in Form »

Fax-in Form »

Or call toll-free:
866-988-9060

Want to learn more?
Please visit www.valueinvestorinsight.com