September 30, 2010

Value Investor INSIGHT

The Leading Authority on Value Investing

Trading Up

David Winters made his career unearthing hidden value in sometimes unexpected places. Today he's finding comparable value – but very much in plain sight.

That David Winters was an early investing fanatic becomes clear when he describes posting on his wall in college a newspaper article about an investor buying the bonds of bankrupt railroads. "I realize that's not how most young men adorned their dorm walls," he says.

Putting this intense focus to productive use, Winters eventually became CEO of Franklin Mutual Advisers, overseeing $35 billion in assets, before in 2005 founding Wintergreen Advisers, whose Wintergreen Fund has since earned a net annualized 5.2%, vs. -0.5% for the S&P 500.

Optimistic at a time when "everybody seems to hate stocks," he's finding opportunity today in such global industries as packaged foods, tobacco, luxury goods and elevators. See page 2

INVESTOR INSIGHT

David Winters
Wintergreen Advisers

Investment Focus: Seeks companies with the "trifecta" of high-quality and growing businesses, shareholder-oriented management and heavily discounted share prices.

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Investor Insight: David Winters

David Winters of Wintergreen Advisers describes why his non-U.S. portfolio exposure has more than doubled in the past five years, which country is currently his favorite, why he thinks M&A is about to take off, which industry makes up almost 20% of his portfolio, and what he thinks the market is missing in Nestlé, Swatch, Schindler and Richemont.

You seem to have developed an early taste for rooting out the obscure and complicated when it comes to investing. How did that happen?

David Winters: My first job out of college was at a small broker in Seattle, where I spent most of my time looking for dirt-cheap stocks in the pink sheets. One of those was Richmond, Fredericksburg & Potomac Railroad, which had among other assets a rail yard in Alexandria, Virginia on the books at 1834 prices. I was in the market for a whopping five shares and eventually became friends with the market maker in the stock, Hans Jacobson. He was probably 80 at the time and I think it tickled him that I was intrigued by the same things he was.

I came east in 1987 to work for Hans as an assistant, which led to a job the next year at Mutual Shares, the fund firm founded by Max Heine, who was a good friend and colleague of Hans's. I started out trading bankrupt bonds and distressed debt and an early deal I worked on involved none other than Richmond, Fredericksburg & Potomac, which another railroad was trying to buy at a fire-sale price. I found a block of the outstanding 7% voting preferred shares that had originally been issued to Civil War widows and figured out how to buy enough of them to file a 13-D and get the attention of the purchasing railroad. Long story short, we ended up getting a much higher price for our shares. Michael Price, my boss at Mutual Shares, loved this type of thing – finding an angle no one knew about to get at hidden value. I had found a professional home.

What aspects of that early focus still exist in your strategy today?

DW: It obviously evolves as the world changes and you're managing more money, but I'd like to believe the core principles are still there. That you have to really dig deeply into the financials to find things others are missing. That you look at all layers of the capital structure. That you pay careful attention to bankruptcies and other distressed situations. That there's money to be made in merger arbitrage. That you take an activist role if something's happening that you consider wrong. And as importantly, that you understand the "softer" side of any given investment, such as who are the primary players and what are their motivations.

When we set up the Wintergreen Fund we made sure to have a prospectus that gives us the ability to do almost anything: equities, fixed income, distressed, arbitrage, bankruptcies, hedging – anywhere in the world. I wanted to have the tools of the best hedge funds, while doing it within a more structured regulatory framework and with a fund that was available to the general public.

Looking at your portfolio today, it doesn't appear particularly exotic.

DW: That's primarily because it doesn't have to be. At a time when large numbers of people have stopped caring about stocks, we believe there are phenomenal opportunities to buy high-quality, liquid equities that offer upside, so the reasons to go obscure or overly exotic matter less.

We've looked extensively at the most distressed situations over the past two years and have found very little of interest. The underlying quality of the assets isn't as good as it used to be, legal and advisory fees take a bigger and bigger chunk of any eventual proceeds, and in the end, you're just trying to make a good trade. We'd rather have the gift that keeps giving as an owner of a great company we've been able to buy into at a bargain price.

David Winters

Starting from Scratch

It wasn't for the glamour that David Winters joined New York City market-maker Herzog Heine Geduld in 1987. The offices of the firm, co-founded by pioneering value investor Max Heine, had duct-tape patches on the carpet and boxes were at times used for chairs. "It was a bit bare bones, but they were also one of the great market-makers in the types of unknown OTC securities I found quite interesting," says Winters.

A year later he joined Heine's mutual fund operation – then called Mutual Shares – where he stayed for 17 years, rising to CEO and Chief Investment Officer of Franklin Mutual Advisers, which by 2005 was a subsidiary of Franklin Resources managing $35 billion in assets.

So why did Winters leave Franklin that year to start his own firm, Wintergreen Advisers? "I wanted to spend more of my time actually managing money, and I wanted to be able to do it with the investment and intellectual flexibility to go wherever the best deals were," he says. "That means no worries about fitting my portfolio into a particular style box or matching it up with a benchmark. As an investor, I wouldn't trade that freedom for anything."

Coca-Cola [KO] is a perfect example. We were in western Africa last November and I got to tour their bottling facility in Dakar, Senegal. I may have been the only analyst who had ever visited, and they were talking with great excitement about how they were expecting average servings of Coke per capita in the region to go from something like 12 to 20 per year over time. That's obviously just an anecdote, but it gives you a sense of the geographic diversity of the company's opportunity and its growth potential in developing markets. That potential had always been expensive to buy into, but last year the share price fell to a valuation that to my mind was just silly. The stock is up nearly 60% from its 2009 low and we continue to think it's attractive.

Another example we still own as well is Franklin Resources [BEN], my former employer. They have a strong balance sheet and a growing international franchise, but when the world was falling apart the stock got so low that you had to pay very little for the underlying money-management business. Again, when you can buy classic, high-quality businesses on sale, you don't need to get too exotic.

All this talk about quality seems a bit out of place for someone who started out buying bankrupt railroad bonds.

DW: I have come to the conclusion, as others have, that in general you find better investments in businesses with good economics, secular tailwinds and sustainable competitive advantages than you do in trying to get one last puff out of proverbial cigar butts. When everything's out of favor and you can buy businesses with bright futures without having to pay for that future, that's a wonderful thing.

For us today, quality means diverse, global and growing streams of free cash flow. It means market positions and industry structures that convey pricing power. It means balance sheets with excess and, ideally, unrecognized assets.

We're also fairly obsessive about the quality of the people running our companies. Whether we're investing in New York, Zurich or Kuala Lumpur, we do everything we can to insure that the people to whom we've entrusted our capital wake up in the morning focused on how to make money for all shareholders and that they're good at it. A lot of that is just seeing what they've accomplished and how they've behaved in the past, but their incentives are also critical. You want to see management own real equity in the business, without the "heads I win, tails I win bigger" types of compensation packages that have been handed out over the years. Many of our management relationships take years to develop and we make a big effort to frequently go see people.

ON INVESTOR ACTIVISM:

Unwillingness to take a stand against poor management and corporate governance helped contribute to the crisis.

Has that been more difficult since you left Franklin Mutual to start Wintergreen?

DW: I was concerned about that starting out, but access hasn't been a problem. People for the most part welcome long-term shareholders with whom they can have a productive exchange. Our portfolio turnover is usually low, and well-run companies appreciate shareholders that think and act as long-term owners.

You haven't shied away from less cordial dialogue at times.

DW: We prefer a much quieter form of activism, but every now and then we need to do more. To get on my soapbox for a minute, I'd argue that the unwillingness of institutional investors to take more of a stand against poor management or corporate governance helped contribute to the crisis. Silence was not the best response to some of the bad behavior going on, particularly in financials.

What prompted your activism at Consolidated-Tomoka Land [CTO]?

DW: The company owns about 11,000 acres of undeveloped land in Daytona Beach, Florida which is on its books at early 20th-century prices and which we believe over time should create significant wealth for shareholders. Management seemed intent to essentially liquidate the company and leave it to others to benefit from the development of the land, so we led a proxy fight last year that resulted in three new, independent directors being named to the board and in more accountability at the board level. There's still work to be done, but we've made a lot of progress in moving the company in a more value-creating direction.

Given what's happened to the Florida real estate market, our timing here has left a bit to be desired. But at today's price [of around $28.50], the shares reflect no possibility of good news, ever. There's an extremely low probability that will turn out to be the case.

Your portfolio has become increasingly global. Do you expect that to be a more permanent shift?

DW: It's become increasingly clear to me that the best opportunities in coming years are going to be outside the U.S. That wasn't the case when I started out, when buying a stock in Canada seemed awfully unusual to people.

Over the past five years we've more than doubled our international exposure, to the point where 65-70% of our portfolio on a look-through basis is invested outside the U.S. Companies able to tap into growing affluence and people's innate desire to improve what they eat, what they wear and how they live will have decided advantages over those focused on mature economies like the U.S. and Europe, where deleveraging will take a long time to work out.

Related to that, we're concerned about the U.S. dollar. As dollar investors, we think it's preferable that our companies make a lot of their money in other currencies. It's sort of a natural, prudent hedge.

What's your fixation with companies based in Switzerland, which make up about 17% of your portfolio?

DW: Switzerland is a little country in the mountains with seven million people and no natural resources other than the intellectual capital of its people. Given that, it has created some of the most globally oriented and successful companies in the world. There's a clear rule of law, the currency is incredibly sound and, for the most part, there's a strong shareholder orientation. When their stocks get inexpensive, as I'll explain shortly, we love Switzerland.

Another big chunk of your portfolio, nearly 20%, is in tobacco stocks. Why?

DW: We do not advocate tobacco consumption, but we do like the businesses of the international companies such as Imperial Tobacco [IMT:LN], British American Tobacco [BTI], Japan Tobacco [2914:JP] and Philip Morris International [PM]. I mentioned our focus earlier on pricing power and the ability to generate geographically diverse streams of free cash flow, both of which are clear strengths of tobacco companies. They also in aggregate tend to be shareholder friendly, raising dividends and buying back stock with excess free cash flow.

Because of the nature of the business, many people don't want to own these stocks. For us, we're just focused on the economic characteristics of the individual companies, which we find compelling. In a world with a lot of uncertainty, we consider them defensive growth stocks.

Are you finding any other industry sectors particularly interesting today?

DW: We're spending a lot of time today on energy, for the straightforward reason that we believe energy prices are going up. We were in Indonesia a couple months ago visiting Astra, which has 55% or so of the country's car market, and they can't build the cars fast enough. The story's the same in much of Asia, which is indicative of the demands we believe are going to be placed over time on an increasingly constrained global oil supply. That tells us that certain companies owning large pools of oil in safe and stable countries are likely to be more valuable than what's currently reflected in their share prices.

With that industry backdrop, we want to own companies based on their asset values and how skilled management has proven to be in building those asset values over time. Two we can mention are Canadian Natural Resources [CNQ], a long-time holding, and Birchcliff Energy [BIR:CN], which we believe is an undiscovered gem. Birchcliff's primary assets are a world-class natural gas field and a low-cost oil deposit in northwestern Alberta. They continue to increase production while operating costs per barrel are falling, usually a nice combination for creating shareholder value.

ON DCF MODELS:

I don't know if lunch will be good today. How am I going to forecast a company's earnings five or ten years out?

You've said you expect mergers and acquisitions activity to pick up. How are you playing that?

DW: We do believe there will be a coming M&A boom, for the same reason we're so optimistic about our portfolio. Smart companies can see the same depressed valuations on valuable assets that we do, so we think it's just a matter of time before deal-making picks up significantly. Once it starts, it's likely to snowball.

While that doesn't fundamentally change where we look for ideas, we are paying attention to industries likely to consolidate, and in those we're looking at the most tempting minnows for the whales. That's behind some of our heightened interest in oil and gas, for example.

While it's not a big position, one of the reasons we like Goldman Sachs [GS] – in addition to its excellent international franchise and fewer competitors – is that it should be a leading beneficiary of increased M&A activity. They may not always love it, but companies are going to continue to need investment bankers.

Describe how you think generally about valuation.

DW: We're not big fans of DCF models because of the garbage-in, garbage-out risk. I don't know if lunch will be good later on today, so how am I going to forecast a company's earnings five or ten years out?

Most of our valuation work focuses on what a company would be worth today in an arm's length transaction. The best sources for that, of course, are comparable recent deals. What Exxon paid for XTO Energy on a Mcf basis is a pretty good mark for the value of natural gas. If anybody knows what it's worth, they should.

We also look at how valuation multiples on a given company or the sum of its parts match up against historical and competitive comps. We don't follow a lot of specific rules, but if you're paying no more than 10-11x earnings for a company with high-quality returns and nice growth prospects, that's attractive – you're paying little or nothing for the future. We're finding a lot like that today.

Let's hear about one, Nestlé [NESN:VX].

DW: Nestlé is the world's largest food and beverage company. It operates in almost every country, but one distinguishing characteristic is that 35% of its sales are in emerging markets. That's up from 25% in 2000, and they're aiming for 45% by 2020. That's helping to drive what is pretty remarkable organic growth for a company with annual sales of more than 100 billion Swiss francs. First-half 2010 revenues were up 6%, in what was certainly a less-than-robust global economic environment.

The product portfolio is extremely wide, with key categories such as coffee

and tea, water, frozen prepared foods, chocolate, ice cream, infant formula and pet food. With the exception of the water business, which has struggled somewhat, most of Nestlé's brands have cross-border appeal and solid pricing power. While you and I might not consider many of the brands "aspirational," they are for increasingly affluent consumers in many parts of the world, which will be a significant driver of growth.

Are you particularly dependent on management acumen in far-flung companies like this?

DW: The company culture has long been one of long-term investment in the future and they've proven to be very smart investors. I think they originally paid something like $280 million for the stake in eye care company Alcon that they recently sold at a huge earnings multiple to Novartis for almost $25 billion. They own a nearly 30% position in French cosmetics firm L'Oreal, for which they also paid a tiny fraction of the current value. You may remember that when Kraft needed money to buy Cadbury, it sold its frozen-pizza business at a price that Warren Buffett [a large Kraft shareholder] publicly criticized as "dumb." Nestlé was the buyer.

Just this past week the company announced it was dramatically stepping up its investment in the development of foods and beverages targeting specific health benefits. Management sees this as an important initiative at the intersection of the food and pharmaceutical industries, which we think is forward-looking and smart.

Trading at a recent 52.45 Swiss francs, the shares at first pass don't seem particularly cheap.

DW: Including the proceeds from the Alcon stake, the company has around 10 Swiss francs per share in cash. After dividends, we estimate free cash flow through the end of 2011 will add another 1.50 per share to that. The L'Oreal stake, based on where it trades on the Paris bourse, is worth 6 Swiss francs per share.

That means you're really paying 35 Swiss francs per share today for a company that analysts expect to earn 3 Swiss francs in 2011, so the multiple is less than 12x. That's just too low for a first-class company with good growth prospects, paying a 3% dividend yield, and that has consistently been buying back stock.

Describe the investment case for elevator/escalator company Schindler [SCHP:SW].

DW: This is another Swiss company that is first-in-class in its business, with an extensive global footprint and an excellent reputation for reliability and craftsmanship. It generates nearly 13 billion Swiss francs in annual revenues, making it comparable in size to Otis, which is a division of United Technologies. Schindler likes to say that its equipment moves more than 900 million people on any given day.

We consider this basically a multi-decade play on urbanization – primarily in Asia – as cities build "up" in developing parts of the world like they have in developed countries. The CIA World Factbook distills levels of urbanization down to a percentage, which as of the latest rendering for the three largest Asian countries was 43% in China, 29% in India and 52% in Indonesia. The comparable numbers were 82% in the U.S. and 90% in the U.K., so there's a lot of potential migration to cities still to come. We've seen numbers that put the Asian urban population at 2.7 billion by 2030, up from 1.8 billion today. As these coun-

INVESTMENT SNAPSHOT

Nestlé
(NESN:VX)

Business: Largest global food and beverage company. Key product categories include coffee and tea, water, dairy, chocolate, frozen foods and pet food.

Share Information
(@9/29/10, Exchange Rate: $1 = CHF 0.98):

Price	**CHF 52.45**
52-Week Range	CHF 42.86 – CHF 54.65
Dividend Yield	3.0%
Market Cap	CHF 181.74 billion

Financials (Full-year 2009)

Sales	CHF 107.62 billion
EBIT Margin	14.6%
Net Profit Margin	9.7%

Valuation Metrics
(Current Price vs. TTM):

	NESN	S&P 500
P/E	20.5	17.3

THE BOTTOM LINE

If one nets out some significant balance sheet assets, the market is assigning a below-average earnings multiple of less than 12x for "a first-class branded-food company with good growth prospects, paying a 3% dividend yield, and that has consistently been buying back stock," says David Winters. "That's just too low."

Sources: Company reports, other publicly available information

tries become more vertical, that should mean a lot of new demand for elevators and escalators.

How cyclical is Schindler's business?

DW: Not as cyclical as you might expect. Total revenues grew a tiny bit in 2008, before declining around 10% in 2009. More importantly, net earnings after taking a hit in 2007 increased sharply in 2008 and set a record last year. In this year's first half, net profit was up another 6%, on 1% revenue growth.

Part of that dynamic is just geographic diversification, as they've offset pullbacks in some parts of the world with excellent growth elsewhere. They won a contract for 109 elevators for what will be Chile's tallest building, in Santiago. Even more recently they signed a deal for 353 escalators at 17 rail stations in China – where Schindler has been established since 1980 – as part of a giant expansion project.

The second key reason for the stability of performance is that roughly half of the company's earnings come from maintenance and product upgrades. These are generally done through annual service contracts and it's not a discretionary expense – if the elevator stops working, you've got to get it fixed. As opposed to being cyclical, we look at this side of the business as a high-profit growth annuity.

How is the corporate governance here?

DW: The company is still controlled through a super-voting share class by the Schindler family. They're super-conservative when it comes to the company's balance sheet and all indications are that they are highly motivated to build long-term value.

The shares, at a recent 105 Swiss francs, are up more than 50% in the past year. What upside are you still seeing?

DW: After backing out 17 Swiss francs per share in net current assets, 1 Swiss franc per share in a minority holding in Hyundai Elevator and 12 Swiss francs per share in free cash flow that should be accumulated through the end of next year, you're paying 75 Swiss francs per share for the business. That's roughly 12.5x the consensus 2011 EPS estimate – which is probably too low – of around 6 Swiss francs.

For only 12.5x, you're getting an irreplaceable global franchise in a business with a strong secular tailwind. I'm not at all suggesting there will be an arm's length transaction for Schindler, but I don't think it's a stretch to say the company would go for twice today's share price if there were an auction.

Continuing with the Swiss theme, explain your interest in Swatch [UHR:VX].

DW: This is one I don't think is on many investors' radar screens, even though it's been a remarkable success story. Swatch has made enormous progress in the last 25 years, starting with a colorful line of watches that really first turned watches into fashion accessories. That kind of marked the revival of the Swiss watch industry and the company has since become the biggest seller of watches in the world, with a portfolio of brands from low-end, like Swatch, to mid-range, like Longines, to the very high-end, such as Breguet.

Watches are exactly the type of thing that people whose disposable income is rising spend money on. I was recently in a museum in Latin America that had an extensive display of jewelry from 10,000 years ago. People have always cared how they look and go to great lengths to adorn

INVESTMENT SNAPSHOT

Schindler
(SCHP:SW)

Business: Market leader in the manufacture, installation and servicing of escalators (#1 market share) and elevators (#2 market share) worldwide.

Share Information
(@9/29/10, Exchange Rate: $1 = CHF 0.98):

Price	**CHF 105.00**
52-Week Range	CHF 66.65 – CHF 107.60
Dividend Yield	1.9%
Market Cap	CHF 12.60 billion

Financials (Full-year 2009)

Sales	CHF 12.86 billion
EBIT Margin	7.7%
Net Profit Margin	5.1%

Valuation Metrics
(Current Price vs. TTM):

	SCHP	S&P 500
P/E	19.5	17.3

SCHP PRICE HISTORY

THE BOTTOM LINE

David Winters considers the company a "multi-decade play on global urbanization," with high-quality earnings coming from an extensive maintenance business. The stock effectively trades for 12.5x estimated 2011 EPS, he says, but he believes the firm in an arm's length transaction would go for twice the current market value.

Sources: Company reports, other publicly available information

themselves to enhance their attractiveness. It's just the way people are. Watches have the added demand kicker that they're really the only acceptable form of jewelry for men.

Swatch is another excellent way to participate in the long-term growth in Asia, which is expected to generate 50% of the company's revenue this year. What better way for someone on his or her way up in the world to announce that fact than with a nicer watch?

What does it take to be good at such a fashion-oriented business?

DW: Most of the same things it takes to be good at any other product business. The brands have to have a reputation for mechanical excellence and reliability. You have to invest in branding and marketing. You have to invest in distribution and make sure it matches well what the brands stand for. And somewhere in the company DNA you have to have a culture and sense of style, both of the enduring and more ephemeral varieties. We believe, and the evidence supports, that Swatch is good at all that.

Is the recent death of the company patriarch, Nicolas Hayek, a concern?

DW: We send our deepest condolences to the family. There's no question he was a driving force behind the company's success, but it's been eight years since his son, Nicolas Hayek Jr., took over as CEO and the company continues to perform extremely well.

How are you looking at valuation with the shares currently at around 363 Swiss francs?

DW: If you subtract from the share price 100 Swiss francs in net current assets (which is essentially inventory at market), 4 Swiss francs for a 9% stake the Chinese watch retailer Hengdeli, and 15 Swiss francs for free cash flow generated through the end of next year, the effective share price is 244 Swiss francs. That's only 11x earnings estimates for next year of 22 francs per share.

There will be ups and downs along the way, but we believe Swatch for a long time will be compounding earnings per share at 15% per year, which isn't at all reflected in the current multiple. Even Hengdeli, the retailer Swatch owns part of that trades in Hong Kong, trades for 20x earnings – and they don't own any brands.

Is the story similar for yet another Swiss success story, Richemont [CFR:VX]?

DW: Many of the elements are the same. Johann Rupert, the chairman and CEO, is one of the great executives in the world, who has created enormous value for shareholders. The company sells a wide variety of aspirational luxury goods, including Cartier jewelry, Jaeger-LeCoultre watches, Montblanc pens and Alfred Dunhill leather goods. Revenues and cash flows are geographically diverse, with Asia (not including Japan) at about 34% of revenues, Europe, 32%, the Americas, 14%, Japan, 12%, the Middle East, 6%, and Russia, 2%. The highest growth, as you'd expect, is in Asia, which only three years ago made up only 20% of the business.

From a product perspective, roughly 50% of revenues come from watches and 25% from jewelry, with those two businesses accounting for the lion's share of profits. Cartier is the crown jewel and clearly one of the most global and sought-after luxury brands in the world.

How has the business weathered the economic upheaval of recent years?

INVESTMENT SNAPSHOT

Swatch
(UHR:VX)

Business: Manufacture and sale of watches, watch components and jewelry worldwide. Key brands include Breguet, Omega, Longines, Rado and Swatch.

Share Information
(@9/29/10, Exchange Rate: $1 = CHF 0.98):

Price	**CHF 362.90**
52-Week Range	CHF 229.00 – CHF 369.20
Dividend Yield	1.1%
Market Cap	CHF 19.47 billion

Financials (Full-year 2009)

Sales	CHF 5.42 billion
Operating Profit Margin	17.6%
Net Profit Margin	14.8%

Valuation Metrics
(Current Price vs. TTM):

	UHR	S&P 500
P/E	21.3	17.3

THE BOTTOM LINE

The company should generate half its revenue in Asia this year, making it an excellent vehicle for participating in the region's long-term disposable-income growth, says David Winters. The effective 11x forward earnings multiple on its stock today doesn't at all reflect the company's ability to compound EPS at 15% annually, he says.

Sources: Company reports, other publicly available information

DW: Remarkably well, which was not due to luck or accident. Their sales in Europe and the United States have fallen about 15% in the last couple of years, but nearly this entire drop has been made up for by increased sales in Asia – where they began shifting investments in new stores and branding several years ago – which are up 19% over the same period. Overall, sales are off just 2% since before the financial crisis and free cash flow hit an all-time high in their 2010 fiscal year. Management has maintained pricing, and in doing so their iconic brand equities as well. They've also recently undertaken a project to streamline purchasing and logistics for their different watch brands, which should help improve margins over time. This is the kind of long-term thinking that we look for and appreciate.

How big a risk to your investment thesis is the onset of a "new normal" economic environment in developed markets, driven by deleveraging consumers who may have less to spend on luxury goods for many years?

DW: Some aspects of a "new normal" may apply to the developed Western world as it recovers from the excesses of the past, but we don't see that being the case for the growing consumer populations in the Far East, where there is enormous wealth and a burgeoning middle class being created. They want what we have, are willing to work very hard to get it, and will increasingly buy things like jewelry and watches as a way of displaying that new wealth. Hong Kong imports more Swiss watches than any other country in the world, with mainland China rapidly catching up to them. Companies like Richemont and Swatch are a great way to get exposure to those markets at sensible valuations.

At a recent 46.80 Swiss francs, how cheap do you consider the shares?

DW: They have the typical conservative Swiss balance sheet, with net cash and short-term investments of 4.50 Swiss francs per share and inventory that we estimate would be worth, if liquidated, another 7 Swiss francs per share. So you're effectively paying around 13x earnings, based on consensus estimated EPS for next year of 2.70.

When people decide they want to own luxury stocks again, the brands and the growth potential here should warrant a much higher valuation. Luxury goods are going to do well again – it's just the way life works.

In general, what in today's unsteady environment worries you the most as an investor?

DW: The threat of nuclear, chemical or biological warfare. There are too many people in the world who might have that in them, which is scary not only for the direct impact, but also for what it might do to society as a whole, to how people think and act over a long period of time.

We thought you were going to say something like the threat of inflation or rising interest rates ...

DW: Not to dismiss those types of risks, but over my time horizon those are things we can deal with. There's a lot of pent up negativity, which is why we've been able to build a portfolio with the highest overall quality level I've ever had. The likelihood that people over time are going to increasingly drink Coca-Cola or buy chocolate bars or trade up on their next watch is all very high. As long as that happens, what the Fed does next or which countries or companies need to be reorganized aren't my foremost concerns. VII

INVESTMENT SNAPSHOT

Richemont
(CFR:VX)

Business: Manufacture, marketing and sale of luxury goods worldwide, including jewelry (Cartier), watches (Piaget) and writing instruments (Montblanc).

Share Information
(@9/29/10, Exchange Rate: $1 = CHF 0.98):

Price	**CHF 46.78**
52-Week Range	CHF 27.14 – CHF 47.00
Dividend Yield	0.7%
Market Cap	CHF 26.86 billion

Financials (FY ending 3/31/10)

Sales	€5.18 billion
Operating Profit Margin	16.0%
Net Profit Margin	11.6%

Valuation Metrics
(Current Price vs. TTM):

	CFR	S&P 500
P/E	32.3	17.3

RICHEMONT PRICE HISTORY

THE BOTTOM LINE

Its operating discipline and investment in stores and branding in fast-growing regions of the world has allowed the company to weather the financial crisis remarkably well, says David Winters. The shares' current effective 13x forward EPS multiple will prove a bargain, he says, "when people decide they want to own luxury stocks again."

Sources: Company reports, other publicly available information