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Value Investor INSIGHT

The Leading Authority on Value Investing

Carrying a Big Stick

The barks of many activist investors are worse than their bites. Such is not the case with Jeffrey Ubben of ValueAct Capital.

The epiphany came to Jeffrey Ubben while managing the then $5 billion Fidelity Value Fund in the mid-1990s: "I just didn't know what I owned. With so much new money coming in, I was constantly adding to 150 positions, which to me was a recipe for mediocrity."

Since leaving Fidelity to join merchant bank Blum Capital and then starting ValueAct Capital in 2000, Ubben's results have been anything but mediocre. By making large bets and working with management and boards to increase shareholder value, ValueAct has returned an annual 18.1% net of fees over the past five years, vs. 6.3% for the Russell 2000.

Ubben is finding his best value opportunities today in mature segments of growth industries, including technology, life sciences and business services. See page 2

INVESTOR INSIGHT

Jeffrey Ubben
ValueAct Capital

Investment Focus: Seeks companies with recurring revenue streams in stable industries and for which "simple" steps can create incremental shareholder value.

Navigating the Turns

Every challenged company has some sort of turnaround story. David Eigen excels in determining in which ones to believe.

INVESTOR INSIGHT

David Eigen
Post Road Capital Management

Investment Focus: Seeks companies positioned to benefit from positive secular trends but currently facing immediate problems that are being credibly addressed.

The key input for David Eigen in researching CKE Restaurants three years ago wasn't a detailed review of its financials or meeting with its CEO, both of which he did. Most important were cold calls to Hardee's assistant managers about how the chain's test menus were faring. "Convincing yourself a broken business is going to stop being broken takes digging," he says.

Such digging has served investors in Eigen's Post Road Capital well, earning a net 11.1% compounded annually since the firm opened in August 2001, vs. an annual 2.5% gain for the S&P 500.

Eigen is finding plenty to buy in recent months. "We haven't ever been this comfortable with our portfolio," he says, adding that it now trades at a 40-50% discount to his estimate of intrinsic value. See page 11

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INVESTMENT HIGHLIGHTS

Other companies in this issue:

Acxiom, Applied Biosystems, Avaya, CKE Restaurants, Del Monte Foods, General Motors, Fairfax Financial, Farmer Mac, J. Jill, Martha Stewart, MBIA, McDonald's, Mentor Corp., News Corp., OmniVision, Palm, Inc., Planar Systems, Research In Motion, Time Warner, Yum Brands

Investor Insight: Jeffrey Ubben

Jeffrey Ubben of San Francisco's ValueAct Capital explains the two most important things he learned from Peter Lynch, why technology companies are ripe targets for activism, what leads him to pick a fight with management and why he sees great value in Reynolds and Reynolds, Catalina Marketing, Williams Scotsman, Gartner Group and Seitel.

You earned your value-investing stripes at Fidelity, which isn't known for its value orientation. How did that come about?

Jeffrey Ubben: As the restaurant analyst in the early 1990s, I had to fight off growth portfolio managers who were beating me up for not participating in the restaurant-IPO boom at the time. The stocks were trading like they were the cure for cancer but so much of it was just a silly paper game. It was clear the industry had attracted too much capital and there was no real focus on the underlying supply/demand dynamics over a longer period of time – it was just a total growth story, with investors dropping ever increasing new stores into their paper models. To me, that's just guessing how long the paper game lasts, not really investing.

Did Peter Lynch influence how you think about investing?

JU: Peter's greatest influence, which still pervades Fidelity, is that you pick up the phone and call companies. At the end of the day, if you haven't spoken to a few companies in existing positions or on new ideas, you go home a failure. That's a good discipline – you should spend your day talking to operators, not to Wall Street.

Another thing Peter does really well is to figure out how else to make money on a good idea. Look right down the industry structure and figure out the other ways that this particular information can generate an edge. In our portfolio today, we identify a theme – say consumer-driven health care – and then we try to figure out where all the opportunities are.

What or who else has had a big influence on your investing style?

JU: I went to work with Dick Blum at Blum Capital Partners in 1995 because he was an originator of the idea of strategic-block investing, which is sourcing ideas in the public markets, committing to a long-term time horizon, and working directly with the companies to fix things.

Early in my time at Blum I saw the power of this type of investing through an investment we made in Kinetic Concepts, which makes high-end therapeutic beds and wound-healing devices. The company had a rental model, with very good unit economics and strong growth, but they were in the market with a secondary offering and nobody showed up. We bought 10% of the company, which was still 60% owned by the founder, and got to know them very well. In 1998, we took a plan to go private to the CEO because the public market just wasn't recognizing the company's value. We ended up doing a $900 million LBO that just worked on all fronts. Making that work from beginning to end was a real breakthrough for me.

Does strategic-block investing describe what you do today?

JU: Yes. We focus on a portfolio of approximately 15 companies. In every company, we try to identify simple things that can be done with the business to create value independent of the market and then we take an active approach in working with management and the board.

What types of companies attract your attention?

JU: We try to focus on businesses that are so good that they're hard to screw up, but many times when management seems to be trying to do just that. Industry structure is very important – we favor relatively slowly evolving industries that are duopolies or have three primary players.

Most of the time we're picking up the pieces after a high-growth company hits

Jeffrey Ubben

Born to Invest

In an industry in which career paths often meander, Jeff Ubben's road to founding ValueAct Capital stands out for its linear, blue-chip progression.

Ubben's father founded Lincoln Capital Management, a growth-oriented investment firm in Chicago. "I grew up doing quarterly-earnings-change analysis in high school," he says. After earning a Northwestern M.B.A., Ubben joined Fidelity Investments in 1987. By 1991 he was running the Fidelity Value Fund, which grew from $500 million in assets to over $5 billion before he left in 1995.

His next stop was San Francisco's Blum Capital Partners, an early practitioner of the same style of "strategic-block" investing – taking big stakes in challenged public companies and working closely with them to fix things – that Ubben practices today in managing ValueAct's $3.2 billion in assets.

"What's most fun is the intellectual challenge of figuring out what the other guy is missing from an investment-opportunity standpoint," says Ubben. "But marrying that with real-world stuff like moving a board to action or helping a new CEO lead a company – that's where we've added the most value."

the wall at 80 miles per hour, having made at least one too many investments to try to sustain an unsustainable growth rate. Public markets can actually conspire to screw companies up. When you're growing fast, you get this big P/E and pretty soon you have all the wrong investors with ridiculous expectations. You try to meet those ridiculous expectations and do things contrary to shareholder value.

That explains your many investments in technology companies.

JU: We're focused on intellectual property and service businesses – technology, life sciences and business services. The boards of once-high-growth companies are usually still venture-capitalist driven and often don't understand that you can't grow your way out of problems any more. Many technology-based industries are mature, with recurring revenue making up a higher percentage of sales. Companies with more-predictable revenue streams should be doing things like leveraging their balance sheets, paying dividends and cutting costs rather than chasing revenue growth.

We don't like to take technology risk, which often leads us to software companies or instrument companies that have a significant service element to them. Our biggest investment is Applied Biosystems [ABI], which is a market leader in producing instruments used as tools for analyzing DNA, RNA, proteins and other molecules. It's been around for a long time, has great intellectual capital and a tremendous installed base. But until two years ago they were run by scientists who were over-investing in R&D and just weren't focused on the bottom line. When they brought in a business person as CEO they stopped wasting R&D money, started taking advantage of their installed base and started caring about margins and cash flows. The upside from all that can be huge.

Is management change often involved in the companies you target?

JU: You don't find great businesses at great prices with great management. Given that, we'll take significant risk with management because as activists we can change that. I would say 80% of the time we're investing around a management change initiated by the board on their own or at our urging. Leadership is everything – it's fascinating how differently the same business can perform with two different leaders.

ON GREAT LEADERS:

Intellectual honesty is the first thing I look for. I want the person who is going to address the elephant in the room.

What do you look for in leadership?

JU: Intellectual honesty is probably first. I want the person who is going to address the elephant in the room. It drives me crazy when you meet with management and there are real issues and they act like they aren't there.

Also important is a contrarian bent, a confidence to go against the prevailing trend. You generally don't want people who are saying this is what we should do because this is what others are doing. You want people who are spending when others are not, and taking chits off the table when everybody else is putting them on.

On what valuation metrics do you focus?

JU: We're looking for a free-cash-flow "coupon" of 10% – EBITDA minus real capital spending minus incremental working capital, divided by enterprise value – combined with a growth profile of 10%. We look three years out at what we think the balance sheet looks like, what the cash flows look like and what type of multiple we should expect – out of that we want to see an annual 20% unlevered return.

The hardest piece to get is the growth. To get really high-quality businesses that have recurring revenue streams and industry structures that are stable, you tend to end up in industries that are very mature. We don't apologize for that because we love the current coupon and it protects us, but the reason we have to look at 100 ideas to find three or four to buy is because it's hard to find enough growth.

We have compromised on the growth rate if we can find more coupon. In the case of Catalina Marketing, which we'll speak about later, it had a 15% coupon when we bought into it, but we were challenged to see much more than 3-5% growth. We still want a combination of the two that gives us a 20% return.

Given your willingness to bid for all of an undervalued company, do you look at some sort of take-out value?

JU: Before we get heavily involved with a company, we do look specifically at an outcome that involves selling the company. It isn't the primary driver, but we see it as a way to protect ourselves, especially when we go on the board. You can get quite illiquid when you join a board.

I would add that we're not after asset plays. To us an asset is only an asset if it generates free cash flow. Just because Level 3 Communications put $15 billion of capital in the ground and it's currently trading at $5 billion doesn't mean squat unless it's generating sustainable EBITDA and ultimately free cash flow. I'm not saying that using another style can't be a great way to make money, but that's not what we do.

How do you manage risk in a concentrated portfolio?

JU: We think our way of investing lowers risk dramatically. If you invest only in quality businesses that generally aren't exposed to external shocks – like union actions or a lot of cyclicality – that are growing 8-10% per year and earning 10% current returns, you don't ever really dig yourself any big holes. We also keep reasonable diversity across industries in the portfolio. We can see markdowns in any one quarter, but over the course of a year we defend capital fairly well. If you cut me some slack for 2002, when we were down 1%, we haven't had a down year in the past 10 years.

Why do companies you invest in tend to be mispriced?

JU: Usually for the typical reasons – temporary poor performance, perceived unfavorable industry conditions, changes in management, accounting adjustments. Wall Street doesn't closely follow most of the companies we invest in, which can also lead to mispricing, especially during some sort of company transition.

We have three- to five-year time horizons and basically try to arbitrage the public market's time horizon. It's still true that the big players in the public markets – particularly mutual funds and hedge funds – are not good at taking short-term pain for long-term gain. The money's very quick to move if performance falls off over short periods of time. As a result, too many big investors are asking what the market wants, which is low volatility, rather than what drives long-term performance. We don't worry about headline risk – once we believe in an asset, we're buying more on any dips because we're focused on the end game three or four years out.

I'm catching a falling sword in almost every situation I'm in, and I'm trying to figure out if it's falling from the second floor or the 10th floor. But my capital base is big enough and my appetite to stay concentrated strong enough that I can patiently over the course of three to six months make the price bottom by buying a little stock every day even as it's going down.

How does your brand of shareholder activism differ from what you see out there today?

JU: Much of what you see today is "buy shares today and tomorrow throw a hissy fit." The focus is on shortening time horizons by being your own catalyst.

That's a problem for me, because that style is transparent and could discredit all activists. Boards can say activists are just worried about making their quarterly or monthly performance numbers, and there's something to that, frankly. Writing a nasty letter is going to lose the pop it has now – the activism is going to have to have more integrity than that.

Activists are going to need the capital base, experience and credibility to follow through – by buying the company or going on the board to help fix it – if steps aren't being taken to address their concerns. You'll need to be more than a yeller and screamer whose biggest asset is that you don't care what anybody thinks about you.

Our idea of activism is to get really involved and help new or current management lead the business and extend the run of a successful investment. The more of our portfolio we can have in great assets with great management where we're helping control the capital decisions – that's nirvana. It's obviously not always a lovefest – we're trying to generate 20% returns, so we have to challenge every company we own with new ideas or they're not going to stay on that 20% curve.

ON WHEN TO FIGHT:

When Acxiom's board said they didn't think it was right to have a large shareholder on the board, I knew we were in trouble.

One of our core holdings is Mentor Corp. [MNT], the industry leader in breast implants for aesthetic and reconstructive purposes. The biggest value creation from our participation there has come from helping convince the founder to hand the business off to the next generation of professional management. The company is able now to do things like selling its urology business, which was the company's heritage, to focus on growth in the aesthetics business, which is one of the all-time great businesses and in which Mentor has tremendous potential to extend its reach for a long time to come.

You're on Mentor's board. Is that necessary to be heard?

JU: It's a very powerful situation when you get risk capital in the boardroom. Most boards are just guessing what shareholders really want and many directors haven't ever written a check to be part of the company. I feel a sense of urgency that typical directors might not when I see a company being led poorly.

That said, it's not necessary to be on the board to have an impact. Most boards and management will listen to large shareholders, whether they're on the board or not.

How did your investment in Acxiom [ACXM] evolve – or devolve – into your making a $25 per share offer for the entire company?

JU: We went to them in 2003 with a plan to realize equity value by getting out of the high-growth game and focusing on growing with their customers at 7-10% per year while emphasizing free cash flow and returns on assets. They responded initially and the stock went up quickly from $16 to $25. We took money off the table at the end of 2004, because we generally like to sell 85-cent dollars to recycle money back into 50-cent dollars.

In 2005, performance relative to the plan they'd laid out went off the tracks when they returned to their old cap-spending ways. We still believed the company was a great asset, so bought back in at $20 and tried to work with them to get back on track. But this time the more we talked with management, the more disingenuous they were, saying one thing and doing another.

I approached the board in the spring of 2005 with our concerns about management's ability to run the company and made a case for why it made sense to have a shareholder in the board room. They came back and said they didn't think it was right ever to have a large shareholder on the board. I knew then we were in trouble. It told me this was an entrenched, founder's board that was not going to make the transition necessary to avoid being a structural underperformer. I had no recourse at that point but to offer a premium for control that would allow us to bring in a new management team and realize the potential of the business.

We've made offers for entire companies in three cases where boards were unresponsive. In one case, OneSource Information Services, we got outbid by a strategic buyer. In the second, MSC Software, we eventually got three guys on the board, including the new CEO. We really do want to own the businesses we make offers on and think we have the governance experience and CEO-recruiting experience to own them.

What's the next step with Acxiom?

JU: We have our board and management slate lined up for a proxy fight. We're not going to back down because there's value here. Companies can get run into the ground when investors just say "to hell with this" and walk away. At the very least, the pressure we're putting on them might result in their performing better than they otherwise would.

Describe your concept of making "farm-team" investments.

JU: We like to live with smaller investments in a company for three to six months before making a full commitment. It gives us an opportunity to even better understand the company and its business while getting to know management and whether we're all on the same page.

Sometimes the stock pops quickly and the valuation gets too high, or we lose some conviction on the attractiveness of the business, or it becomes clear that management and/or the board is not interested in developing a positive relationship. We very infrequently purposefully pick a fight, so we'll just move on.

Our goal is that by the time we're ready to commit to taking a 10%-plus stake in a company we know the business cold and have bonded with management so that we're really in it together.

Tell us about Reynolds & Reynolds [REY], a holding you've recently "called up" to the big leagues.

JU: Reynolds provides dealer-management software and services to auto retailers. There's an incredible industry dynamic: Reynolds and ADP split 80% of the market and sell their services on a monthly basis, so most of the revenues are recurring in nature. Auto dealers generally aren't technologists, so you don't tend to have competitive battles over the fastest, newest thing.

I've followed the company for 15 years, since I was an analyst at Fidelity. Over the past five years we visited them three times before investing at all. What became clear was that the company was being run by a technologist who was always betting on the new gee-whiz thing and was gutting and demoralizing his sales force. Then his fancy new system didn't work and that was the end of him.

We met the new CEO, Fin O'Neill, and came away thinking he was a leader who will make the hard decisions. We bought some stock but didn't fully commit until he wrote off $90 million of capitalized software related to the technology the old CEO had bet the company's future on. That's a hard decision – they already had 70 customers on the new system.

What's the new game plan?

JU: The company makes 15% operating margins with 75% of its revenue on auto-

INVESTMENT SNAPSHOT

Reynolds and Reynolds Co.
(NYSE: REY)

Business: Provider of information management systems and services to automotive retailers and original-equipment manufacturers in the U.S. and Canada.

Share Information
(@1/30/06):

Price	**28.06**
52-Week Range	24.72 – 29.20
Dividend Yield	1.6%
Market Cap	$2.14 billion

Financials (TTM):

Revenue	$978.0 million
Operating Profit Margin	15.6%
Net Profit Margin	9.0%

Valuation Metrics
(Current Price vs. TTM):

	REY	S&P 500
P/E	20.8	22.0
P/CF	13.3	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
ValueAct Capital	9.7%
Franklin Resources	5.9%
Kayne Anderson Rudnick Inv Mgmt	5.3%
Amvescap	4.7%
LSV Asset Mgmt	4.4%

Short Interest (As of 1/9/06):

Shares Short/Float	1.9%

REY PRICE HISTORY

THE BOTTOM LINE

New CEO Fin O'Neill's back-to-basics sales and marketing strategy, coupled with a broad cost-cutting effort, should result in strong gains in operating profitability, says Jeffrey Ubben. He expects the company's earnings power – as well as its stock price – to double within the next two to three years.

Sources: Company reports, other publicly available information

pilot, but its earnings and stock price have done very little over the last five years. The first critical thing is to rebuild the sales organization, giving incentives back and organizing to be more responsive to customer needs.

Auto dealers need help in talking to their customers directly, so the company is providing add-on customer-relationship-management solutions that you're starting to see show up in top-line growth. If they can get revenues growing even 5-7% per year, there's tremendous profitability leverage, especially as they pursue broad-based cost cutting that wasn't going to happen under the old CEO.

The overall formula is pretty simple: Get the margins to 20% by turning around an underperforming recurring revenue stream and cutting costs. Buy back stock with the significant amount of cash they have on their balance sheet. Watch earnings per share grow rapidly and then get back to a historical multiple on a much higher EPS. It's not rocket science.

With the stock currently around $28, what do you see as the upside?

JU: We've been thrown a curve ball on this. The company has had to stop buying back stock because their auditors are making them go back and look at some of their accounting for long-term software contracts. That's not affecting the stock price because the market has figured out there's no fundamental new information in any of this. But it's disappointing that some of the buybacks have been delayed.

This doesn't change anything in how we look at the business or stock. We think the earnings power of the company is $2.50 per share, almost double the $1.30 they make now. So even with no multiple expansion, we think the stock can double within two to three years.

Didn't you buy another of your core holdings, Catalina Marketing [POS], during some sort of accounting problem?

JU: Yes. We first bought Catalina two years ago in the middle of an accounting issue about long-term revenue recognition in which the auditor resigned. The whole issue is arcane and usually has more to say about auditors covering their backs than fundamental business issues.

In Catalina's case it was clear from the 10-Qs and 10-Ks that the free cash being generated by the business was still there and in most cases growing. Cash doesn't lie. When people bail on a company because of an arcane accounting issue when the cash flow is there, we love it.

What attracts you to Catalina's business?

JU: Catalina over more than 20 years has built a network of coupon printers that are installed in more than 85% of all U.S. supermarkets. Consumer purchases trigger coupons to be printed for products of the company's consumer-packaged-goods clients. Redemption rates are 8 to 10 times those of traditional coupons. The competitive moat is substantial and protected by the very powerful network effects of reaching and having information on more than 200 million U.S. shoppers.

What got us particularly interested was that management seemed to be giving up on the core business and was "diworsifying," as they say. They were making terrible capital-allocation decisions like buying up Japanese billboard companies.

INVESTMENT SNAPSHOT

Catalina Marketing Corp.
(NYSE: POS)

Business: Delivers point-of-sale coupons and other marketing communications for client packaged-goods and pharmaceutical manufacturers worldwide.

Share Information
(@1/30/06):

Price	**22.25**
52-Week Range	21.71 – 27.90
Dividend Yield	1.3%
Market Cap	$1.07 billion

Financials (TTM):

Revenue	$403.8 million
Operating Profit Margin	25.1%
Net Profit Margin	15.6%

Valuation Metrics
(Current Price vs. TTM):

	POS	S&P 500
P/E	16.4	22.0
P/CF	10.0	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
ValueAct Capital	15.1%
Barclays Bank	11.2%
T. Rowe Price Assoc	8.6%
Kayne Anderson Rudnick Inv Mgmt	5.2%
Cooke & Bieler	3.7%

Short Interest (As of 1/9/06):

Shares Short/Float	10.6%

POS PRICE HISTORY

THE BOTTOM LINE

Greater marketer demand for accountability plays to the company's strength in providing targeted-marketing solutions with demonstrable results, says Jeffrey Ubben. He expects 20% annual gains from the shares, without "the optionality from what else they might do with this asset of real-time information on 100 million transactions a day."

Sources: Company reports, other publicly available information

You had to look through all the capital spending to realize the core business was still cranking out cash flow, and that in the right hands it was worth a lot more than the stock price reflected.

You played a role in the installation of a new CEO, so what's happening now?

JU: Previous management had given up on the core business because they stopped investing in the network and equipment. They stopped growing their footprint of retail outlets. They didn't generate any new products. The coupons looked the same as they did 10 years ago.

New management is changing all that. They just added two significant retail partners in Walgreens and Kmart. They're expanding their pharmacy channel, which places ads on the back of the instruction sheet that patients receive when they pick up prescription drugs. They're adding color printing for the coupons. They've gotten out of peripheral businesses.

The big picture here is the opportunity in offering targeted-marketing solutions. Marketers are seeing that the emperor has no clothes in broadcast media, so money is increasingly going into promotions for which you can look at the dollars spent and figure out if there's a return. Accountability is where the world is going, which plays to Catalina's strengths.

What's weighing on the stock, currently trading near $22?

JU: Generating sustainable growth is an issue. We believe much of the problem is prior management's not investing in the core business. With new leadership only in place for a year, much of the upside from their investment spending is still to come.

There's also a headwind in the supermarket business from Wal-Mart, which is taking more than 1% in market share each year from supermarkets. But 40% of Catalina's revenues are away from U.S. supermarkets altogether – in pharmacies and international – both of which are vibrant businesses for them and growing at double-digit rates. Even if growth is challenged with U.S. supermarkets, 40% of the top line growing quickly elsewhere can move the needle pretty well.

I also frankly think that Wal-Mart might be an opportunity. Whenever there's an easy bear story, it's always smart to see how it might get turned on its head. What if Catalina did something with Wal-Mart?

ON SELLERS' MOTIVATION:

If I can understand what the seller is afraid of and it's either irrational or overdone, that's where you find opportunity.

Is understanding the bear story something you pay close attention to?

JU: My father tells me the reason I generate the returns I do is that I see things other people don't see. But that's not exactly the case. I spend my time trying to figure out what the person selling stock to me is afraid of. If I can understand what he's afraid of and it's either irrational or overdone, that's where you can find opportunity.

What upside potential do you see here?

JU: We believe this is a solid 20% per year return – and that's without considering the optionality of what they might do with this tremendous asset of real-time information on 100 million transactions a day. Management is right to fix the core business first, but there will be a lot to build on. Catalina has never done anything on the syndicated-research side, for example. I also think there are some interesting business opportunities around their pharmacy business, say, as Medicare and the government are looking to better communicate with healthcare consumers.

Tell us about modular space rentals and Williams Scotsman [WLSC].

JU: Williams Scotsman is the largest national provider of mobile and modular space rentals. We got to know the business from owning McGrath RentCorp a few years ago and understand how terrific a business it is. Somebody else builds you a modular, you rent it to someone like a school district and they keep renewing because it takes them longer to build permanent space then they thought, and then you take it back, say, in ten years and sell it for what you paid for it. Those are the basic economics. There are tremendous gains on sale because the depreciation that runs through the financial statements is not economic.

Scotsman is the only national player in the industry, with a diversified business mix of roughly 30% education, 30% non-residential real estate, and smaller markets in health care, government – Katrina has been huge for them – and Canadian oil and gas companies that have seasonal operations. The national footprint should allow them to move things around and run at a fairly high utilization rate.

The company executed a leveraged buyout in 1992 and then put a lot more debt on in 1997 even while they started to overbuild – along with the rest of the industry – from 1997 to 2000. Utilization rates went down from around 88% to 80%, which is where they still are today. Because of all the excess supply, market prices fell 10-15% and are just now starting to recover.

Do you see a catalyst turning things around?

JU: Even with these challenges, EBITDA still stayed basically flat and the company was servicing $1 billion worth of debt – the business is that good.

The story now is relatively simple. The industry has worked through its oversupply, and if you look at the demand characteristics in Scotsman's different markets, we think we're basically at the bottom in terms of capacity utilization and price. Demand is set to grow at double-digit annual rates and the utilization gains from that all drop to the bottom line. Price gains from that all drop to the bottom line as well. On top of that is an ability to profitably grow the fleet – now about 80,000 units – which generates about a 16% unlevered return based on current yields and a $12,000 cost per unit.

We think those levers will result in EBITDA growing at double-digit rates, hitting $250 million within a couple of years. One of the reasons I love the company is its leveraged capital structure, which generates a low cost of capital at a low level of risk given the high level of visibility of the revenue stream. On a small share base, they can create a lot of value going forward by paying down debt with the growing cash flow. It's great to be able to buy a company with an LBO-like capital structure that's coming off the bottom fundamentally.

Now around $19, where do you see the share price two years out?

JU: With an 8.5x EBITDA multiple, reasonable compared to industry peers, you get to a stock price of $30 on what I think they'll be earning in two years.

INVESTMENT SNAPSHOT

Williams Scotsman, Inc.
(Nasdaq: WLSC)

Business: Provides rental mobile and modular space solutions for education, commercial, industrial and government markets principally in North America.

Share Information
(@1/30/06):

Price	**19.06**
52-Week Range	14.15 – 19.10
Dividend Yield	0.0%
Market Cap	$745.6 million

Financials (TTM):

Revenue	$547.5 million
Operating Profit Margin	17.1%
Net Profit Margin	(-3.7%)

Valuation Metrics
(Current Price vs. TTM):

	WLSC	S&P 500
P/E	n/a	22.0
P/CF	12.3	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
ValueAct Capital	7.3%
TimesSquare Capital Mgmt	2.7%
Friess Assoc	2.5%
Barclays Bank	1.9%
Dawson-Herman Capital Mgmt	1.7%

Short Interest (As of 1/9/06):

Shares Short/Float	1.7%

WLSC PRICE HISTORY

THE BOTTOM LINE

Jeffrey Ubben believes the modular-space-rental business is "at the bottom in terms of capacity utilization and price." Strong earnings gains from increases in utilization rates and prices flowing directly to the bottom line, he says, should result in a target stock price of $30 within two years – a nearly 60% premium to today's price.

Sources: Company reports, other publicly available information

One of your longer-lived holdings, Gartner Group [IT], hasn't so far been earning your 20% per year target. Why?

JU: Sometimes our companies run off the rails and it takes some time for them to get back on track.

Gartner is the leading subscription-based research company focused on the professional information-technology industry. The research provides critical information for the IT executive making a purchase decision or wanting to benchmark current IT performance. Gartner's independence is highly valued and renewal rates have historically been 75-80%, even in downturns.

We bought our first shares in mid-2001 and had made a lot of money on them two years into the investment, but the company was putting out guidance calls that were flat to down while the economy and technology spending were recovering. Not unlike what had happened at Catalina, it was a CEO problem. He was doing all this other sideshow stuff to try to grow away from the core technology-research business, which he thought was mature.

This is another great example of a business so good it could withstand tremendous amounts of turmoil and mismanagement. All we needed was the right CEO. Gene Hall was hired from ADP and he's been energizing the core research business, which is where Gartner makes all its money and where the incremental margins are. I also was asked to join the board.

How is the business being energized?

JU: The company bought Meta Group, its number-two research competitor, in December of 2004. The acquisition brought 90 more salespeople that filled gaps in Gartner's own sales force and eliminated some competition. The company now has about a 90% market share in syndicated research for senior technology executives – with an incremental margin in reselling content of 90%.

Gene Hall has been investing in and reorganizing the sales force, which had been through years of confused messages and inconsistent bonuses. He also recognized that the sales effort should have more of a user orientation than one focused on vendors. They used to have 20 people selling to IBM but only two selling to JPMorgan Chase, when it should be the opposite.

Another key piece of the puzzle has been to refocus on per-desktop pricing and away from some of the big "enterprise" deals that had been done, which essentially were giving away a lot of economics to customers. That's going to have a positive impact on both revenues and renewal rates.

Won't technology capital spending, which hasn't been particularly robust, impact Gartner's potential growth?

JU: The business world went through a pretty nasty recession in 2001, though the overall economic numbers didn't look so bad because consumers kept spending. I think the same thing is due to happen in the inverse – the consumer is going to hit some real problems, but the commercial world is really quite healthy. Businesses have more cash than they know what to do with and have some pent-up demand. You could have a consumer-driven recession now and Gartner's business would still be fine.

The stock, at just under $14, has recovered nicely from its lows of last April. Is there still room to run?

JU: Because I'm on the board, I have to be careful about saying anything about future earnings. I think the company is absolutely doing the right things and is well positioned for good things to happen.

Tell us about your investment in the energy business, Seitel [SELA.OB].

JU: The story here is straight-forward. Seitel has the largest library of North American 3D seismic data – an information set that they just sell over and over to oil and gas companies to aid in their exploration efforts. It's not unlike Gartner in that it's reselling syndicated information.

Until less than a year ago, energy company exploration and development spending was roughly 80% development and 20% exploration. With rising oil and gas prices, that mix is starting to shift dramatically toward exploration, and Seitel's business is driven by exploration. At the same time, overall capital spending is going up, so the company benefits from both absolute spending increases and changes in the mix. That dynamic is only starting to show up in Seitel's revenue numbers.

The stock is up nearly 90% in the past year, to around $2.50. Hasn't the market already caught on?

JU: The company is still extremely cheap. Their revenues, minus selling, general and administrative costs and minus company-funded capital spending, is about $60 million. That's only 1.2x enterprise value of about $50 million.

Seitel has more operational financial leverage, because you're reselling a library, than anything in the oil-services business. In oil services you're lucky to get 20-25% incremental margins – here those margins are 70-80%.

The stock is up, but we think it's still

INVESTMENT SNAPSHOT

Gartner, Inc.
(NYSE: IT)

Business: Independent global provider of research and analysis on information technology, computer hardware, software, communications and related industries.

Share Information
(@1/30/06):

Price	**13.94**
52-Week Range	8.06 – 14.16
Dividend Yield	0.0%
Market Cap	$1.58 billion

Financials (TTM):

Revenue	$955.1 million
Operating Profit Margin	7.0%
Net Profit Margin	(-1.3%)

Valuation Metrics
(Current Price vs. TTM):

	IT	S&P 500
P/E	n/a	22.0
P/CF	53.8	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
ValueAct Capital	16.2%
David A. Rocker	4.4%
Sterling Capital Mgmt	3.0%
Artisan Partners	2.9%
Royce & Assoc	2.8%

Short Interest (As of 1/9/06):

Shares Short/Float	9.6%

IT PRICE HISTORY

THE BOTTOM LINE

CEO Gene Hall has been "energizing" Gartner's core research business, says Jeffrey Ubben, through acquisition, focusing sales efforts more on users than vendors, and more-profitable pricing strategies. The company, he says, is ideally positioned to benefit from "pent-up" capital spending demand by cash-rich corporations.

Sources: Company reports, other publicly available information

very interesting and is going to make investors a lot of money.

Are there industries you stay away from?

JU: One thing about being an investor for 20 years is that experience leads you to write off big chunks of the market. I don't do retail because you have to recreate the demand every day. I don't do financial services because it's a spread business with no real free cash in it – you have to grow equity to grow assets to make more spread. I don't do much in industrials because the capital demands are high and, long-term, the cost structure – particularly with labor and energy prices – is challenging in a global economy. I don't do commodities – we like price-makers that set prices based on value added, as opposed to price takers.

If you buy a high-quality business, you only have to be right once – buying at the right price. The sale is fairly easy to execute. In cyclical or commodity areas, you have to be right twice, on the buy and the sell. If you miss the exit, it might be awhile before it comes back around.

What new areas you are exploring?

JU: We're spending a lot of time on mobile computing and voice over Internet. They aren't easy to find, but we think there are ways for value guys to invest there.

Take Avaya [AV]. In a lot of its markets it competes mostly just with Cisco, so it's a two-company horserace. Their product sales are growing at double-digit rates as people transition off telephone land lines. Half of their revenue stream is services and they under-earn on that, which is an execution issue. It's trading at less than 1x sales. We're hoping to get to know management better to understand their plan to maximize value. All of this makes it the type of situation that attracts our attention.

What recurring investment mistakes have you found yourself making?

JU: I've learned from experience to avoid acquisition-driven stories during the actual acquisition-growth phase – big problems always come of that.

I've also recently concluded is that if you find yourself going back to the well with the same idea a third time, you're not generating enough ideas and are likely to get killed. You're not as vigilant as you should be because you think you know it already. When I find myself doing that, I tell myself I'm just not working hard enough.

Your investment in Martha Stewart Living turned out okay, but certainly looked like a big mistake for quite awhile.

JU: One thing activism can do is allow you to really dive in and fix something to avoid having to sell at the bottom. After Martha was convicted, it would have been easy for me to sell the stock at $6 and just admit I made a mistake in betting on this person. But I believed enough in the core brand that I figured I could work to bring it back. Activism in that sense was putting the train back on the tracks.

Did you ever imagine the market would bail you out and take the stock over $35 when Martha got out of jail?

JU: I never did understand that, but sometimes it's better to be lucky than smart. Sometimes you earn your luck from all the pain you've had to endure. VII

INVESTMENT SNAPSHOT

Seitel, Inc.
(OTC BB: SELA.OB)

Business: Provider of seismic data and related geophysical services to aid oil and gas exploration, development and reserve management in North America.

Share Information
(@1/30/06):

Price	**2.52**
52-Week Range	1.22 – 2.63
Dividend Yield	0.0%
Market Cap	$387.3 million

Financials (TTM):

Revenue	$141.7 million
Operating Profit Margin	5.3%
Net Profit Margin	(-6.2%)

Valuation Metrics
(Current Price vs. TTM):

	SELA	S&P 500
P/E	n/a	22.0
P/CF	4.1	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
ValueAct Capital	18.7%
Paradigm Capital	1.9%
Pinnacle Assoc	1.8%
Kennedy Capital Mgmt	1.5%
American Capital Mgmt	0.7%

Short Interest (As of 1/9/06):

Shares Short/Float	n/a

SELA PRICE HISTORY

THE BOTTOM LINE

Seitel stock "is going to make investors a lot of money," says Jeffrey Ubben, as the company resells its library of North American 3D seismic data to oil and gas companies with growing exploration and development budgets. The company, he says, "has more operational leverage than anything in the oil-services business."

Sources: Company reports, other publicly available information

Investor Insight: David Eigen

David Eigen of Post Road Capital Management describes how vice and scandal create investment opportunity, where he's finding his best short ideas and what he thinks the market is missing in Molson Coors, Spectrum Brands, Marsh & McLennan and Neteller.

You grew up with family in the real estate business. How has that influenced your investing style?

David Eigen: An ideal situation in real estate is to buy a decent building in a good location that needs work, fix it up and then eventually re-rent it from a B tenant at a B price to an A tenant at an A price. You buy at one capitalization rate and then can re-finance at a lower one, taking the cash from the additional leverage to buy other buildings. Or you might sell altogether at a much higher price. That's a good analogy for how we think about the turnaround companies in our portfolio – we try to invest in what is perceived to be a B or C company that we believe can turn into an A company. Those investments can make you a lot of money.

Real estate investing is also very focused on cash-on-cash returns – always thinking when you put a dollar in about what you expect to get back. When I started in college to read Warren Buffett and Benjamin Graham, their focus on return on invested capital always made a lot of sense to me.

The book that impacted me the most as I was becoming an investor, though, was Philip Fisher's *Common Stocks and Uncommon Profits*. You really only have to read the first 50 pages to understand how important it is for companies to get all aspects of their business to work together and also to see the benefit of doing field research to support your ideas.

Give an example of the type of field research you do.

DE: Our best performing idea ever, CKE Restaurants, originally came from me sitting in my living room reading *Value Line*. It caught my eye because it was trading at only 4x cash flow.

In this case the stock was so cheap because the company's Hardee's business was broken and the market was pricing into the stock that it would never be fixed. In fact, we thought the successful Carl's Jr. piece of the business was worth more than the stock price, so Hardee's appeared to be worth less than zero. If you could find value in Hardee's – if they could make it perform more like Carl's Jr. – there was a lot of upside in the stock.

On a visit to the company we heard about focus-group feedback on the new menu and format they were putting in at Hardee's. The reviews were excellent. But focus groups are one thing and actual behavior can be another. So we asked for a list of markets where they'd done the focus groups and started calling stores in those markets. We talked to franchise owners, but also called stores in the evenings to try to get more assistant managers – they're less likely to know the corporate line, willing to speak with you, and definitely know if their stores are turning around.

We called three dozen restaurants and found that the buy-in from customers and franchise owners was tremendous. That's usually your best endorsement, so I started buying on the belief that Hardee's was about to turn around, and it did.

Our sweet spot is the turnaround the market isn't buying into yet. Where you make a ton of money is not just buying cheap stocks of broken businesses, but cheap stocks of broken businesses where you have conviction that it's going to stop being broken. That's what all those phone calls gave us about Hardee's.

Does your process generally start with the quantitative and move to the qualitative?

DE: We do all the traditional upfront analysis value investors do and also have a simple point-system discipline to make

David Eigen

Seeing Irrationality Up Close

When David Eigen founded VitaSave, Inc. in 1996 to sell discounted nutritional supplements and natural health and beauty aids, the business plan was focused on a traditional catalog business, supported by online retailing. Before long, however, well-heeled competitors were springing up online, bidding customer-acquisition costs to unsustainable levels. "Just doing the math, it was clear that playing the growth-at-any-cost game was not going to work," he says.

Eigen's plan to build the business more traditionally offline, however, fell on deaf ears. "The only thing that mattered to venture capitalists at the time was market share and how you were going to become the Amazon.com of your industry," he says. Rather than pursue a strategy he didn't believe in, Eigen sold to one of the competitors in January 1999 and turned to investing full-time.

"Not falling for the mania can be hard, especially when you're in the middle of it," he says, "But that's exactly what good investors have to do." And how did his investing portfolio fare after the bubble popped? "Very well," he says. "I never bought a single dot.com."

sure we're considering both risk and reward with some rigor.

The reward part is much more quantitative. We create an intrinsic value out of what we believe the normalized earnings power of the company will be in two to three years, based on free cash flow, times whatever multiple we think the market will award it. We then add to that the cash we think the company will earn over those few years. We try to build a balanced portfolio with both mature, stable-cash-flow companies – where we may accept a 30% discount to intrinsic value, – and higher-risk turnarounds where we want to see 40-60% discounts before we buy.

The risk analysis takes into account several things. We look at the long-term competitive dynamics of the industry, the positioning of the company's products or services, its proven historical track record and how management is incented. On the more qualitative side, we pay a lot of attention to the quality of management and the culture of the company.

Give an example of how company culture informed an investment thesis?

DE: One of the reasons I shorted General Motors [GM] starting in the summer of 2004 was because I just didn't believe the culture of the company could accommodate the extent of upheaval that was truly required by the reality of their financial and market situation. I bought very inexpensive put options when the stock was around $37, covered most of the position at $25 and then closed out when the stock went above $30 after Kirk Kerkorian announced his involvement.

That was a mistake, with GM stock now under $25.

DE: I'm still kicking myself over that. I had huge conviction, but gave in to all the noise at the time that religion would be forced upon them. Cultures that ingrained, as we've obviously seen, change extremely slowly.

Another example of a dysfunctional culture is Time Warner [TWX]. This company should be broken up, not necessarily for the reasons Carl Icahn is giving, but because they don't have a culture that can bring the businesses together for the common good. AOL should be the most amazing platform for Time Warner content, but it's not. Time Warner Cable should be a great platform for launching new cable channels, but it's not. Given that, you might as well split it up and perhaps the market will give the independent parts a greater total valuation. News Corp., by the way, has exactly the opposite culture, which is why I think they'll be so much more successful.

ON INVESTMENT THEMES:

On the long side, we're spending a lot of time on how trends in human behavior will translate into business opportunity.

We keep hearing that about News Corp. [NWS-A], but it doesn't seem to be helping the stock at all.

DE: One reason the market is uneasy about News Corp. is concern over the Internet acquisitions they've made. They bought the parent of MySpace.com last summer for roughly $580 million and I believe that will eventually be viewed as one of the great steals of all time. MySpace is a social-networking phenomenon – they did 12.5 billion page views in December – and the pace of sign-up is accelerating rather than decelerating. News Corp. has a global infrastructure and culture that will take advantage of that like almost no other company could. I believe revenues from their Internet businesses will be $1 billion by 2008 and then take off from that, which is a level no one on Wall Street is expecting.

You mentioned bailing on your GM position too soon, is that a common mistake you make?

DE: I've actually at times had the opposite problem with long positions. Four years ago, I bought shares of Universal Stainless & Alloy, a specialty steel company that does a lot of business with manufacturers for the utility industry. Soon after I bought, I saw a press release from General Electric's turbine business that they were taking a big gain from the cancellation of orders from several utility customers. I knew GE was Universal's biggest customer, so I called the company and wanted to go see them. They put me off because they said they were in a quiet period. The next week they came out with a release saying they were lowering earnings guidance and the stock was cut in half.

The lesson I've learned is that when something spooks me, I should more often take advantage of the liquidity of the market to get out and finish the work on whatever the new issues are. If you determine the problem is a big one, you can avoid a lot of pain. If you conclude the problem is only temporary, you can always get back in at a lower price.

Any other lessons you've come by the hard way?

DE: Like many value investors, we had no material investments in energy last year. We had invested considerable time in researching several energy companies and believed that the supply-demand characteristics were positive and that they were excellent hedges against the risks of rising raw-material costs in a lot of our consumer stocks. We just didn't pull the trigger because we were uncomfortable betting on commodity prices. That's okay, but in cases like this where we could hedge against risk in other long positions, that's something we'd like to do.

You've said you're focusing more on broader investment themes to help source ideas. What themes do you currently find interesting?

DE: On the long side, we're spending a lot of time on how trends in human behavior will translate into business opportunity. For example, the increasing pace of people's lives makes them more mobile, so there's going to be more need for mobile communications. People eating more on the run globally provides opportunity for the best fast-food companies and is a big reason we own McDonald's [MCD] and Yum Brands [YUM]. One key reason we own Del Monte Foods [DLM] is because they're being smart about repackaging their foods so they're quick to eat.

We're also active in areas benefiting from both human and government addiction to vices, such as alcohol, tobacco and gambling. That people will succumb to such vices and that governments will look to the sale of them as a great source of tax dollars, we believe, is at least as inevitable as things like selling more Coca-Cola around the world.

What short themes are you pursuing?

DE: We're finding short opportunities right now in specialty retailers in overcrowded markets – like women's apparel and consumer electronics – that have tough comparable sales to live up to. In general, we think manufacturers and retailers of discretionary, "nice to have" products in highly competitive markets will take a hit in the slower consumer-spending environment we see coming.

I'm also expecting to be very active on the short side of companies deeply involved in adjustable-rate mortgages. All of the infrastructure built in recent years is becoming an increased burden as volumes slow. Rising interest rates are resulting in more competition from fixed-rate loans. We also think the government will act to address some of the high-risk lending that's going on – it's just now that a lot of adjustable-rate mortgages are starting to roll over and by next year I think you'll start to see the rate adjustments cause some real pain.

With markets responding so quickly to news these days, is shorting getting more difficult?

DE: We are being less patient with our shorts. Because of the amount of private-equity and other money out there looking for bargains, we try to not be too greedy and take profits more quickly now than we did even a year ago.

We were short retailer J. Jill [JILL] in the last half of last year and the stock was going down because of a declining catalog business and what we felt was a retail concept that had major competitive, merchandising and inventory issues. Then in December Liz Claiborne expressed interest in buying the company at 40% over the market price – at a 55x forward P/E multiple. We think it's a completely irrational offer, given that we believe J. Jill is just going into crisis mode, but it killed what had been a very profitable short position up to that point.

Tell us about one of your "vice" bets, Molson Coors Brewing [TAP].

DE: We originally got interested in the beer space by watching Anheuser-Busch keep getting cheaper and then hearing Warren Buffett talk about why he was buying its stock at last year's Berkshire Hathaway annual meeting. We still thought Busch was too expensive, but were intrigued by the industry and started looking at the other big players.

With the merger of Coors and Molson, which closed about a year ago, Molson Coors is now the fifth-largest brewer by volume in the world, with strong brands

INVESTMENT SNAPSHOT

Molson Coors Brewing Co.
(NYSE: TAP)

Business: Fifth-largest global brewer with primary operations in the U.S., U.K. and Canada. Brands include Molson, Coors, Keystone, Grolsch and Carling.

Share Information
(@ 1/30/05):

Price	**62.36**
52-Week Range	57.37 – 79.99
Dividend Yield	2.0%
Market Cap	$5.32 billion

Financials (TTM):

Revenue	$5.40 billion
Operating Profit Margin	9.2%
Net Profit Margin	3.1%

Valuation Metrics
(Current Price vs. TTM):

	TAP	S&P 500
P/E	21.7	22.0
P/CF	13.2	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
Southeastern Asset Mgmt	7.2%
Amvescap	6.9%
Fidelity Mgmt & Res	4.1%
Barclays Bank	2.2%
Vanguard Group	2.1%

Short Interest (@ 1/9/06):

Shares Short/Float	5.8%

TAP PRICE HISTORY

THE BOTTOM LINE

The market is underestimating the newly merged company's ability to compete effectively against industry giants and its ability to wring cost savings out of the combined operation, says David Eigen. He expects strong growth in free cash flow to result in a share price of $103 by 2008, 40% above today's price.

Sources: Company reports, other publicly available information

primarily in the U.S., Canada and the U.K. The stock has been held back for a couple main reasons: fear of a price war they'd lose against bigger competitors like Anheuser-Busch and SABMiller, and skepticism about the realization of benefits from the merger.

What's the market missing?

DE: First, we think the threat of a prolonged domestic price war is less likely and would be less harmful to Molson Coors than is typically perceived. The company has excellent core brands globally that can withstand aggressive price competition. Our experience with price wars in other industries leads us to believe some of the competitive price pressures will continue to dissipate. Why would Budweiser and Miller destroy their brands by forcing consumers to think of their products as cheap junk, which McDonald's and Burger King almost did and, by the way, General Motors and Ford did?

Has Anheuser-Busch stopped cutting prices?

DE: They've actually announced price increases and a desire to stop the price wars, which will benefit all beer producers in the U.S.

How is the merger integration going?

DE: The company identified $175 million of pre-tax annual cost savings from the merger – from combining facilities, better procurement and cuts in information technology and overhead – which by all indications they are on track to meet. Management has also proven to be very smart in finding operating efficiencies related to logistics. Coors in the U.S. had been doing almost everything by truck, but the company is now more aggressively using rail transport, which we think alone can improve gross margins by 5% over the next few years. They've also just agreed to sell their Brazilian operation, which was a disaster and losing $60 million a year.

Is there more to the story than cutting?

DE: Sales volumes have been pretty flat, but we're optimistic. They brought in a new president of North American operations from Nike and have already been more innovative and consumer-oriented on the product side. They had a great product launch last year with a 12-pack that came in an actual cooler and we expect to see more innovation like that.

ON THE FICKLE MARKET:

One surprising thing is how quickly the market has turned on [Spectrum] management. They didn't get stupid overnight.

Given their product mix, they'll also benefit significantly in the U.K. from an ongoing shift in consumer tastes from ales to lagers and from the move to more drinking at home. And while this is only a one-time pick-up, the return of professional hockey – after last season's strike – will benefit them in Canada.

With the stock at around $62, how are you looking at valuation?

DE: With the merger and operational savings, we expect operating profits to grow strongly, even assuming only GDP-type growth in revenue. We expect free cash flow to be $675 million by 2008, up from an estimated $500 million last year. At the 13x multiple we think they'll deserve on that – vs. an 11x multiple today – we have a target price of $103.

Risks?

DE: The price wars could start again, but I just don't see how that makes sense for anyone. Also concerning would be a continued shift in alcohol consumption away from beer toward spirits. But given how little growth I've already built into my numbers, the shift would actually have to accelerate to be much of a problem.

As a backstop, if Anheuser-Busch, SABMiller and AmBev turn out to be just too big to compete against, I'm sure we'll see further consolidation in the beer industry. In particular, SABMiller or Heineken would be ideal buyers for Molson Coors. Based on acquisition multiples paid in the past, I'd expect the company to be worth a minimum 50% premium to today's market price to a buyer.

One of your turnarounds the market doesn't seem to be buying yet is Spectrum Brands [SPC].

DE: Spectrum is a company that has been built up essentially from the leveraged buyout of the Rayovac battery business in 1996. In recent years they started to diversify, buying the Remington shaving business in 2003 and last year acquiring lawn and garden, insect control and pet-related products in an effort to better leverage their global distribution capabilities and diversify away from batteries.

Just as the company was significantly levering its balance sheet last year, it got hit with several operating challenges. Rising commodity prices impacted margins. Their European battery business was hurt by a continued increase in private-label competition. In North America, excess battery inventories industry-wide resulted in significant price cutting in the fourth quarter. The company had to adjust earnings guidance three times last year after July.

All of which would explain why the share price, at around $21.50, is down nearly 55% from its 52-week high of $46.

DE: One surprising thing here is how quickly the market has turned on management. Top management has basically been in place since the LBO ten years ago and has not only done an excellent job but has been perceived by the market to have done an excellent job until just last summer. We don't believe management got stupid overnight.

With all the noise, we think the market is missing the significant free-cash-flow growth coming for the company. They are going to take a tremendous amount of cost out of the business over the next couple of years, not only from further integration synergies but also from restructuring businesses that need it, like the European battery business. They're moving manufacturing to lower-cost countries. They have pricing leverage in specific categories of the lawn-and-garden and battery businesses, which will help recoup increased commodity costs.

At the same time, there's upside from the remaking of the Rayovac business in the U.S., focusing its marketing more on improved product performance than price and getting improved retail placement at Wal-Mart. They've also been successful in expanding Remington brands in the U.K. and Latin America, which will continue, and have big opportunity in continental Europe as well.

What upside do you see for the stock?

DE: If management executes as we believe they will, free cash flow should grow from the current pro-forma level of $180 million to at least $240 million by 2008. That's assuming only 1-2% annual revenue growth. Put a reasonable 12x multiple on that and we get a target price of $56, which is more than two-and-a-half times where the stock is today. Even if cash flow stayed flat at $180 million, the stock still only trades for 6x that figure, which gives us a great margin of safety.

We just think the market has severely over-reacted to the challenges here and that management is more than up to meeting them.

The market seems similarly skeptical of your next turnaround idea, Marsh & McLennan [MMC].

DE: One theme we're paying attention to is the increasing globalization of business and we like the mix of services Marsh provides to growing businesses in a wide range of markets. Their four main divisions are in insurance brokerage, risk consulting and services, management consulting, and investment management. All of these businesses have very low costs of capital and little need for capital spending, so returns on invested capital are generally quite high.

The story, of course, is that two of the businesses, the Marsh insurance brokerage and the Putnam Investments division, were caught in scandals – Marsh in the contingency-fee scandal and Putnam from allowing after-market trading. As a result, margins in these divisions are at historic lows. The question then is whether you believe these businesses will turn around.

What gives you conviction they will?

DE: From the chairmanship down through the top management of these two divisions there are new people in charge. We've done a lot of work on these people and believe they're top-notch and have unquestionable integrity. The insurance group is moving fast to rebuild client relationships and increase employee-retention rates, which are now approaching historic levels. Putnam has changed its incentive structures and now the overall investment performance – so critical in that business – is improving.

Both of these businesses have great economics. The insurance brokerage

INVESTMENT SNAPSHOT

Spectrum Brands, Inc.
(NYSE: SPC)

Business: Global branded consumer-products company with primary operations in batteries (Rayovac), electric shaving (Remington) and pet supplies (Tetra).

Share Information
(@ 1/30/05):

Price	**21.47**
52-Week Range	16.00 – 46.11
Dividend Yield	0.0%
Market Cap	$1.09 billion

Financials (TTM):

Revenue	$2.36 billion
Operating Profit Margin	11.4%
Net Profit Margin	2.0%

Valuation Metrics
(Current Price vs. TTM):

	SPC	S&P 500
P/E	18.7	22.0
P/CF	4.3	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
Thomas H. Lee Partners	23.7%
American Express Financial	9.2%
Wachovia Corp	5.7%
Nominingue Asset Mgmt	4.2%
Glenview Capital	4.1%

Short Interest (@ 1/9/06):

Shares Short/Float	11.0%

SPC PRICE HISTORY

THE BOTTOM LINE

Investments in the U.S. battery and European shaving-products businesses, coupled with aggressive cost cutting following acquisitions in the past year, will drive strong growth in Spectrum's free cash flow, says David Eigen. He believes the shares should be worth $56 by 2008, a 160% premium to today's price.

Sources: Company reports, other publicly available information

business benefits from secular global growth in demand for insurance products, without the risk of catastrophic losses that the insurers have to bear. In fact, when disasters happen, pricing tends to firm and broker dollar margins go up. In money management, Putnam traditionally has earned 20-25% operating margins – even with all the problems it still earns 15%.

In both of these businesses the margins are still well below those of competitors and we see no reason why over time they can't return to competitive levels of profitability. Customers generally have pretty short memories when a level of trust is regained and they're presented with a solid, competitive product or offer.

So is this mostly a question of regaining what's been lost?

DE: That's a major part of the case in brokerage and money-management. We're also excited about the Kroll security business, which does everything from providing corporate security guards, to doing background checks, to providing global risk assessment and management services. This business is well situated to prosper in a more complex, inter-connected world and should continue to grow 20% annually.

INVESTMENT SNAPSHOT

Marsh & McLennan Companies, Inc.
(NYSE: MMC)

Business: Global professional-services firm with primary operations in insurance brokerage, security and risk management, consulting, and investment management.

Share Information
(@ 1/30/05):

Price	**30.60**
52-Week Range	26.67 – 34.25
Dividend Yield	2.2%
Market Cap	$16.67 billion

Financials (TTM):

Revenue	$12.16 billion
Operating Profit Margin	7.7%
Net Profit Margin	(-2.6%)

Valuation Metrics
(Current Price vs. TTM):

	MMC	S&P 500
P/E	n/a	22.0
P/CF	82.13	14.7

Largest Institutional Owners
(@9/30/05):

Company	% Owned
Capital Res & Mgmt	8.5%
T. Rowe Price Assoc	7.5%
Pacific Financial Res	6.0%
Barclays Bank	3.3%
Davis Selected Adv	3.2%

Short Interest (@ 1/9/06):

Shares Short/Float	1.8%

MMC PRICE HISTORY

THE BOTTOM LINE

David Eigen believes the market has yet to recognize the turnarounds underway at the company's scandal-plagued insurance-brokerage and investment-management businesses. He expects strong earnings growth as those businesses return to historical profitability, resulting in a share price by 2008 of $59 – nearly double today's price.

Sources: Company reports, other publicly available information

Since tanking 15 months ago, the stock's done little and now trades at $30.60. What potential do you see?

DE: Given the quality of these businesses, they should be worth a 15-17x multiple of free cash flow. We estimate free cash flow jumping to $1.85 billion in 2008, primarily from improving margins at Putnam and the Marsh insurance brokerage business. Put a 15x multiple on that, plus the cash we estimate they'll have by then, and you've got a $59 stock.

There's also a nice margin of safety in a current breakup value we calculate in the mid-$40s. Management is committed to fixing the businesses, but if that's proving difficult we're confident they'll create value by breaking up the company.

I understand the market wants to see more proof. But if you wait until a turnaround is obvious to everyone, you can leave a lot of money on the table.

From scandals to gambling, tell us about Neteller [NLR.L].

DE: Neteller is an Isle of Man-based company that essentially is to online gambling what PayPal is to online retail – an alternative payment system. The company provides a secure online funds-transfer service that enables gamblers to load, withdraw and transfer funds to and from an electronic "wallet" for use at any gambling site that supports Neteller's online payment system. More than 90% of online gaming sites support the Neteller system.

Neteller earns money from users when they add to their e-wallet and from host sites when gamblers move from site to site with their Neteller e-wallet in tow. Merchants love Neteller because it guarantees the funds its users gamble with and because it has expertise in dealing with things like proving if a user is old enough. Neteller also can settle in multiple currencies, which allows broader marketing opportunities for the gambling sites.

What is Neteller's market position?

DE: They handle about 20% of total global online gambling payments.

They're most established with U.S. gamblers, have a good-sized operation in the U.K. and are prepared to grow rapidly in Asia after making acquisitions in Japan and China.

A head start means a lot here. They already have a global infrastructure that works across many languages and in a wide variety of regulatory environments. That's not at all easy for new players to replicate.

Our bet then is on their being very well positioned to prosper from an overall growth in online gambling – poker, sports betting and all types of casino-type gaming – that we just think is unstoppable. Neteller revenue was $83 million in 2004, was more than $170 million in 2005 and should be well over $240 million this year.

We assume the regulatory issues are not insubstantial.

DE: Regulatory risk will always be an issue with a stock like this. There has been legislation introduced in the Senate by Senator Kyle of Arizona that has strict prohibitions on Internet gambling. But since Katrina hit, there's been no movement on the bill. My basic feeling is that it will be something legislated by states in the U.S., and as long as the economic interests of the states are met, I don't really believe this will be legislated away.

At 795 pence on the London exchange, the shares have quadrupled in less than two years. Has it gotten too pricey?

DE: The current market cap is around $1.7 billion, for a company that will generate a minimum of $140 million in free cash flow this year. So it trades at less than 13x 2006 free cash and they have lots of cash and no debt on the balance sheet.

With companies growing this quickly it's hard to model a price target. This one isn't for the faint of heart – the stock is volatile and there is U.S. regulatory risk that won't go away. But if things keep going as they are and if Asia really takes off for them as we think it will, this could have incredible upside.

You take to heart the advice of people like Charlie Munger and Bill Miller to cast a wide net for insight on investing. What have you come across recently that has had an influence.

DE: The book that's had the most impact on me recently is *The Wisdom of Crowds* by James Surowiecki. One of the many anecdotes he recounts is from long ago at a country fair where people were asked to guess the weight of a cow. Hundreds of people guessed and nobody got that close, but if you took an average of all the guesses it was within a few pounds of the cow's actual weight. The idea is that if you have a diverse set of inputs you can come to more accurate conclusions.

One of my mistakes historically has been to anchor on my traditional sources of information and ideas. When I looked at the things I tended to read and people I tended to listen to, I realized they were all too similar in how they viewed the world. I didn't have nearly enough diversity of input, something which I'm fundamentally changing.

In almost every field, from medicine to finance to science, you see the collective opinion upended by new information. But the level of group-think by even the best and the brightest is amazing. This is why I think you'll always find opportunities in value investing. There will be legions of experts who all believe the same things and who will influence the masses, but will often be wrong. If you do your own work and seek new angles from which to approach problems, you'll continue to find things to make money on. VII

INVESTMENT SNAPSHOT

Neteller plc
(London: NLR)

Business: Provider of secure online funds-transfer services for primary use by customers at poker, sports-betting and other gambling websites.

Share Information
(@1/30/06, Exchange Rate: $1 = 56.6 pence):

Price (in British pence)	**795.00 ($14.05)**
52-Week Range (in pence)	435.50 – 919.50
Dividend Yield	0.0%
Market Cap	$1.69 billion

Financials (TTM):

Revenue	$146.0 million
Operating Profit Margin	56.8%
Net Profit Margin	50.7%

Valuation Metrics
(Current Price vs. TTM):

	NLR	FTSE 100
P/E	22.9	19.2

NLR PRICE HISTORY

THE BOTTOM LINE

Its established global presence in providing funds-transfer services for online gamblers positions Neteller well to prosper from an overall growth in online gambling that David Eigen calls "unstoppable." At only 13x his estimate of 2006 free cash flow, Eigen believes the share price significantly underestimates the company's growth potential.

Sources: Post Road Capital Management, company reports, other publicly available information

Bear Necessities

Given how our bearish bets have performed in the past couple of years, we've asked ourselves why we bother betting on the downside at all. Here's why. ***By Whitney Tilson and Glenn Tongue***

Given the long-term upward trend in equity prices and frequent bouts of excessive investor optimism – "Markets can remain irrational longer than you can remain solvent," John Maynard Keynes once warned – one might ask why make bearish bets at all. This question is particularly relevant to us given the money we've lost in this area over the past couple of years.

After carefully studying our experience, we're not swearing off negative bets for two main reasons: First, we still think we can make money on them. In addition, they remain a great tool for hedging against risk. That said, some refinements in our strategy are in order as we learn from our mistakes.

Be Specific

Two years ago we became convinced that the technology sector in general – and semiconductor stocks in particular – had become significantly overvalued. Following its nearly 80% decline from March 10, 2000 through October 9, 2002, the Nasdaq had rallied dramatically, rising 80% from its 2002 low through the end of 2003. We were amazed to see the froth returning to the very stocks that had obliterated investors only a couple of years earlier and believed that, across the technology sector, the fundamentals did not remotely support the stock prices.

Rather than shorting or buying puts on individual tech stocks, we felt the best way to profit from the perceived overvaluation was to buy puts on two baskets of stocks: the Nasdaq-100 Trust [QQQQ] and Semiconductor HOLDRS [SMH]. While we might not understand many of the companies that make up these baskets well enough to make a bearish investment, we believed, in aggregate, that these indices were sure to decline materially.

Initially, our investment worked well as the Nasdaq-100 and SMH were down more than 12% and 30%, respectively, over the first seven-and-a-half months we held them. Alas, we weren't clever enough to take our profits and instead held as both indicies rallied through the end of 2005. Of course, the passage of time was also eroding the value of the puts. We sold these positions at a loss late last year and don't plan to reinitiate them.

We made two mistakes here: First, we strayed outside our circle of competence – always a bad idea – and tried to compensate by buying a basket of stocks. Second, for us, a basket is a poor way to express an investment opinion, bullish or bearish. Our advantage as investors is detailed, bottom-up stock research, and we give up much of that advantage when we invest in a basket. Assuming we sufficiently understand at least certain companies within a sector, we will almost certainly be better off buying or shorting the most undervalued or overvalued stocks in the sector rather than investing in a basket (*see box*).

While we've abandoned making bearish bets on baskets as a way to make money, we still use puts on such indicies as the S&P 500 and Russell 2000 for hedging because: 1) It reduces risk, defined as the permanent loss of capital; 2) In the event of a major correction, it will provide us with substantial cash to invest at bargain prices, thereby enhancing returns; and 3) It allows us to remain invested in certain stocks we otherwise might sell prematurely, which also should enhance returns.

Hedging 80-cent dollars

The last point warrants further discussion. Like many value investors, we tend to sell our winners much too early. Because we're so conservative, our estimates of intrinsic value are usually low and, even if they aren't, the market often tends to push our winners far above intrinsic value – at least for a time. There are few things more annoying than buying a stock at $10, selling it from $15 to $20 and then watching it go to $50.

Here's an example of how we've hedged one of our favorite positions to

Getting More Specific

Making a bet on a basket of stocks or an index – either bullish or bearish – can be a poor way for bottom-up investors to express an investment opinion. So rather than making bearish bets on baskets of technology or financial stocks – two areas in which we currently see pockets of significant overvaluation – we've taken negative positions on the following individual stocks. *Whitney Tilson and Glenn Tongue*

Company	Ticker	Industry	Price @1/30/06	52-Week Low	52-Week High
Fairfax Financial	FFH	Insurance	151.10	126.73	179.90
Farmer Mac	AGM	Agricultural/Rural Mortgages	28.50	15.53	32.47
MBIA	MBI	Financial-Guarantee Insurance	62.68	49.07	64.00
OmniVision	OVTI	Imaging Semiconductors	25.22	11.74	25.58
Palm, Inc.	PALM	Mobile Computing	37.47	20.75	37.95
Planar Systems	PLNR	Flat-Panel Displays	13.25	7.19	13.25
Research In Motion	RIMM	Wireless Communications	66.82	51.90	84.55

avoid selling too soon – and why we don't regret losing money on the hedging so far: We think McDonald's [MCD, $35.78] is easily worth $40 per share, based on a 16x multiple of the $2.50 per share of free cash flow we think the company can earn in the not-too-distant future. When the stock hit $32 in late 2004 – having risen steadily from a low of around $12 in March 2003, when we last purchased it – it was, in our opinion, the proverbial 80-cent dollar.

In the past we might have sold and locked in our gains, but this would have triggered big taxes and, more importantly, denied us the healthy long-term compounding we expect from this stock over many years to come. Instead we bought long-dated puts on the S&P 500, which we felt were very attractively priced, with a notional value proportional to our holdings in McDonald's. In this way, we could hedge our McDonald's position against the possibility of a substantial market decline, yet still benefit from the upside of an undervalued stock that we believed was highly likely to outperform the S&P 500 over time.

So what has happened? The S&P 500 has risen, volatility has fallen and time has elapsed, all of which have caused the S&P 500 put position to decline. Multiply this across a number of positions and it's easy to see how this strategy lost us a lot of money.

Is hedging 80-cent dollars – when the cost of hedging is at or near all-time lows – the wrong strategy? We don't believe so. Buying insurance always looks wrong in hindsight when the event you insured against doesn't happen. But the fact that our home didn't burn down last year doesn't mean we're upset that we lost 100% of our "investment" in our home-insurance policy – and it doesn't keep us from renewing our policy.

HEDGING AS INSURANCE:

The fact our home didn't burn down doesn't mean we're upset we lost 100% of our "investment" in home insurance.

Capital preservation is far more important to us than keeping up with the S&P 500 over short time periods. We do believe, however, that we erred somewhat in how we sized our "insurance" policies – in essence, we took a good idea and overdid it. All of our index put positions tended to move together, so we effectively had more insurance than we needed. This served us well during the down months of 2005, but cost us for the year as a whole. In addition, our buying of at-the-money puts was, in hindsight, a mistake. We're not trying to hedge against modest 5-10% declines, but against a much larger correction, so we've recently been buying 10% out-of-the-money puts. Finally, our macro concerns lessened our confidence in our long stock positions more than they should have. We're still hedging our 80-cent dollars, but at what we now think are more appropriate levels.

Funds managed by Whitney Tilson and Glenn Tongue own puts on the S&P 500, Russell 2000 and MBIA, and are short Fairfax Financial, Farmer Mac, MBIA, OmniVision, Palm, Inc., Planar Systems and Research In Motion.

Anything's Possible

Most investors know that investing is an exercise in probability. But knowing it and actually living by it can be two separate things.

"Games of chance must be distinguished from games in which skill makes a difference," writes Peter Bernstein in *Against the Gods*, his historic review of risk taking. "With one group the outcome is determined by fate, with the other group, choice comes into play. There are card players and racetrack bettors who are genuine professionals, but no one makes a successful profession out of shooting craps."

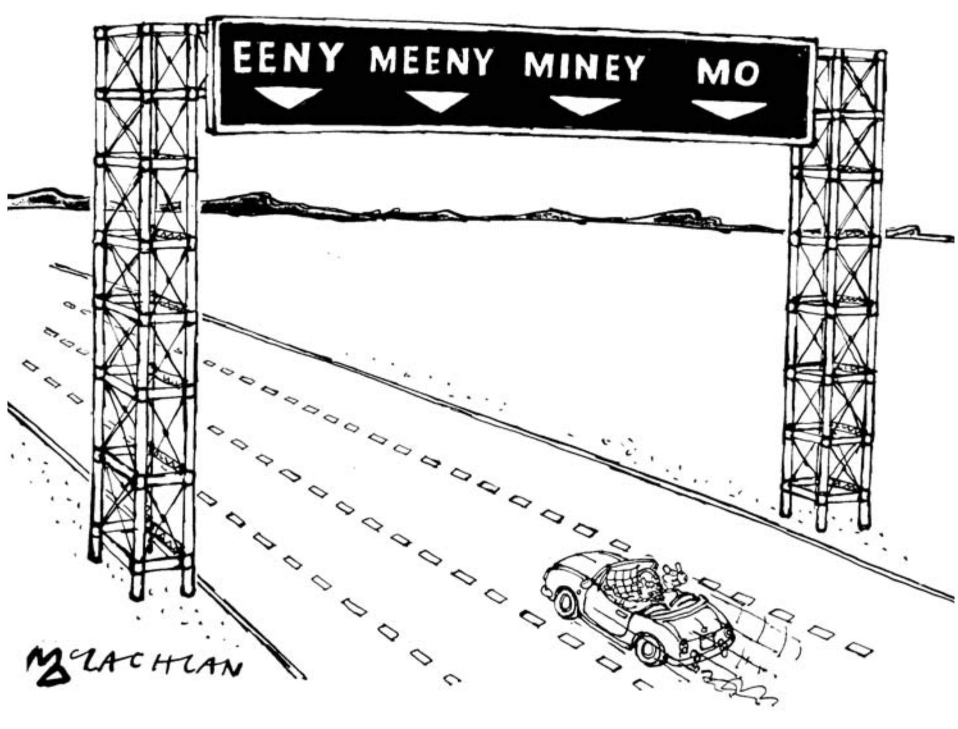
Like playing poker and betting on horses, investing is a game of skill similarly focused on assessing the odds of uncertain future events. "At the end of the day, investing is inherently a probability exercise," says Legg Mason strategist Michael Mauboussin. "Most investors acknowledge this point but very few live by it."

Why is it difficult for investors to think in terms of probabilities when assessing a company's future performance and stock price? "It isn't human nature to view the future in terms of a wide range of possibilities," says Abingdon Capital's Bryan Jacoboski, who was featured last summer in *Value Investor Insight* (August 29, 2005). "We naturally think in terms of what is most likely to occur and implicitly assess the probability of that scenario occurring at 100%. That may sound reckless, but it's what most people do and isn't a bad way to think as long as less likely, but still plausible, scenarios don't have vastly different outcomes. In the investment world, however, they often do, so making decisions solely on the most likely outcome can cause severe damage."

Anchoring on the most likely outcome is a natural attempt to reduce the complexity involved in making investment decisions, but also can reflect the dangerous overconfidence with which many investors ply their trade. Former Treasury Secretary and Goldman Sachs Co-Chairman Robert Rubin, who made his name on Wall Street as an arbitrage trader, warns against this "excessive certainty" in his book *In an Uncertain World*: "[It] seems to me to misunderstand the very nature of reality – its complexity and ambiguity – and thereby provides a rather poor basis for working through decisions in a way that is likely to lead to the best results."

The first basic step in incorporating probabilities into investment decisions is to explicitly consider several potential outcomes. Abingdon Capital's Jacoboski looks at each of his holding's business fundamentals under four to six distinct scenarios, calculating an intrinsic value under each scenario and applying a subjective probability to each. The final estimate of intrinsic value is the intrinsic value of each scenario weighted by its probability of occurring. "A key is to capture low-probability but high-impact scenarios, primarily to see where the vulnerabilities are," he says. He decided not to short Amazon.com a couple years ago, for example, after taking into consideration what he considered to be the unlikely event that Amazon's scale would start translating into the profitability gains the market was expecting. In fact, that is the scenario that began to play out, and the stock rose 180% in the following year.

An added benefit to thinking in terms of probabilities is that it helps make explicit the actual risks under consideration. If given the choice between purchasing a $350 non-refundable plane ticket to attend a future event that could possibly be cancelled vs. waiting to buy a last-minute ticket for $1,200, many people would choose to wait. Nobody wants to blow $350. But in pure expected-value terms, it pays to buy the ticket now unless you believe the risk of cancellation is above 71%. Framing the question in this way may not change the decision, but can increase the chances that a more informed decision is made.



In studying the common traits of those most successful at games of skill – across disciplines – researchers have found a clear tendency to focus more on process than individual outcomes. Poker legend Amarillo Slim has described it this way: "The result of one particular game doesn't mean a damn thing, and that's why one of my mantras has always been 'Decisions, not results.' Do the right thing enough times and the results will take care of themselves in the long run." Adds Legg Mason's Mauboussin: "By definition, poor decisions will periodically result in good outcomes and good decisions will lead to poor outcomes. The best in their class focus on establishing a superior process, with the understanding that outcomes will follow over time."

That's not to say that process can't be improved. Making explicit – and writing down – the probabilities used in making investment decisions can provide valuable learning. After all, if you judge an event to have had a 60% chance of occurring – and it doesn't occur – you don't know if you were right or wrong. The only true way to know is by tracking the same or similar events to see if they, over time, happen 60% of the time. Weather forecasters and bookmakers keep track of such things to refine their ability to judge probabilities. Investors should do the same – even if it's with much less precision – to calibrate their probability-setting skills.

ON PLAYING THE ODDS:

The issue is not which horse is the likely winner, but which horse offers odds that exceed their actual chances of victory.

While necessary, skillfully assessing the probabilities of various outcomes for a company is not sufficient to making a sound investment. Stock prices have future expectations already built in – the trick is to find the gaps between those expectations and your own.

"Perhaps the single greatest error in the investment business is a failure to distinguish between knowledge of a company's fundamentals and the expectations implied by the stock price," says Mauboussin. Driving home this point is Steven Crist, chairman of the *Daily Racing Form*: "The issue is not which horse in the race is the most likely winner, but which horse or horses are offering odds that exceed their actual chances of victory. There is no such thing as "liking" a horse to win a race, only an attractive discrepancy between his chances and his price."

Even with a framework to assess ambiguity, the right decision in the face of great uncertainty is often just to pass. Warren Buffett refers to it as placing something in the "too-hard pile." Writes Peter Bernstein: "Once we act, we forfeit the option of waiting until new information comes along. As a result, not acting has value. The more uncertain the outcome, the greater may be the value of procrastination." VII

When the Road Less Traveled Gets Congested

Value investors, rightfully so, pride themselves on following the road less traveled. After all, it's tough to have much of an edge in an investment when everybody's in agreement on it. As legendary Wall Street investor Bernard Baruch succinctly put it: "Never follow the crowd."

Investment manager Evergreen Capital Management has quantified the virtue of this sentiment by analyzing past data on mutual-fund inflows and outflows. It found that when relative flows into a given fund sector or style exceeded one standard deviation above historic norms at the same time the P/E ratios relative to the S&P 500 were above historic averages, "the odds are overwhelming that over the next two years that sector will underperform," says David Hay, Evergreen's Chief Investment Officer.

On the surface, that isn't great news for value investors. With money flowing freely into value funds after years of strong performance, Evergreen's analysis suggests the party is over. "Value investing is too popular," says Hay. In fact, small-cap-value and mid-cap-value are two fund categories Evergreen now recommends avoiding altogether. (The third such category is REITs.)

While we don't at all question the validity of these recommendations in the aggregate, does this mean individual value investors should move to the sidelines and wait for the current cycle of popularity to pass? We think not.

For starters, there is really no "typical" value investment to avoid. We've been consistently impressed in our conversations with the best value investors by the breadth of their ideas and of the strategies they employ. Recommendations in these pages have come from nearly every industry – from steel to semiconductors, from newspapers to videogames, from trucking to wireless Internet.

Great value investors are also adaptable, or, as Legg Mason's Bill Miller describes it, willing "to take what the market gives us." That many value investors are finding plenty to buy among what have traditionally been considered large-cap growth companies is testament to this adaptability.

In the middle of describing the relative values he's currently seeing based on market capitalization, Jeffrey Ubben of ValueAct Capital during his interview for this issue stopped himself and said: "You know, we're so bottoms-up that a lot of this isn't relevant." Which is, of course, the point. Portfolios are built one stock at a time, and in each case the value investor is looking to buy something for less than it's worth. Some are better at it than others, of course, but that's not something that can go out of style.

Creative Inaction

Bill Miller's latest quarterly commentary was typically filled with wit and wisdom, including this on trading: "We practice the Taoist wei wu wei, the 'doing not doing' as regards our portfolio. We are mostly inert when it comes to shuffling the portfolio around, with turnover that has averaged in the 15-20% range. Many funds have turnover in excess of 100% per year, as they constantly react to events or try to take advantage of short-term price moves. We usually do neither. We believe successful investing involves anticipating change, not reacting to it."

John Heins
Co-Editor-in-Chief

Whitney Tilson
Co-Editor-in-Chief

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