ValueInvestor INSIGHT
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Logical Conclusion

Patient investors are often deemed unable to react quickly, says Michael Cook, whose success would indicate that the opposite is closer to the truth.

There's nothing fancy about Michael Cook's investing approach, in which he emphasizes attention to detail, sticking to one's knitting and the need to rely on facts and logic over assumptions and hype. "Employ these values in almost any endeavor and they should translate reasonably well to good outcomes," he says.

The outcomes have certainly proven good for Cook's SouthernSun Asset Management investors. The firm's flagship small-cap strategy since 1990 has earned a net annualized 12.3%, vs. 9.4% for the Russell 2000.

Targeting smaller companies with big profiles in their businesses, he's finding opportunity today in widely diverse areas such as consumer electronics, automotive supply, industrial infrastructure, recreational vehicles and underwear. See page 2

INVESTOR INSIGHT

Michael Cook
SouthernSun Asset Management

Investment Focus: Seeks companies whose dominance in niche markets, financial strength and management adaptability are being misjudged by the market.


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Inside this Issue

Investor Insight: Michael Cook

SouthernSun Asset Management's Michael Cook, Michael Cross, Elliot Cunningham and Peter Matthews describe the three filters through which they view all prospective investments, the system check they use at the end of their research process, and what they think the market is missing in Knowles, Tenneco, Hanesbrands, Chicago Bridge & Iron and Thor.

The core beliefs you've outlined behind how SouthernSun invests – things like "be thorough," "be systematic," "reality trumps hype" – seem to err on the side of basic common sense. Is that the point?

Michael Cook: When I talk about our core beliefs, I'm describing practices that are consistent with good logic and tend to apply broadly to any good decision-making. Taken together, we think they make us both better prepared to react to what's in front of us and more patient in letting time become our friend rather than our enemy. While you and I may consider it all common sense, a great many investment decisions don't get made this way, which we think can give us an advantage.

You focus in evaluating companies on three primary areas: niche dominance, financial flexibility and management adaptability. Describe what you mean by each.

MC: We're trying to find businesses with strong market positions that are reasonably well protected by things like technology leadership, cost advantages and distribution strength. Their competitors typically look different than they do, either because they're divisions of much larger companies on the one hand, or because they're smaller and privately held on the other.

A good example in the portfolio today would be Knowles [KN], which was founded nearly 70 years ago – its technology was used in Neil Armstrong's audio transmission from the moon – and today is the leading global manufacturer of hearing aids as well as of the microphones used in consumer electronics. The company was spun out of Dover Corp. last year and not long thereafter had to pull its microphone components out of Apple 6 iPhones due to a manufacturing defect. We have concluded the problem was temporary rather than permanent and that the company's leadership position in two attractive markets is worth a lot more than the market has been willing to pay.

Another example of the type of company we like is Centene [CNC], which is the top provider of Medicaid and other healthcare-related services to state governments. We originally bought the stock a few years ago when everyone was so afraid the Affordable Care Act would negatively impact the company's business, but we thought it was well positioned to take advantage of the trend toward states' outsourcing their Medicaid programs, something we believed would happen irrespective of healthcare legislation. That continues to play out while healthcare reform, by expanding the number of people eligible for Medicaid, has so far turned out to be a tailwind rather than a headwind. We've taken some profits on the stock, but still own a sizeable stake.

In terms of financial flexibility, our emphasis is on organic revenue growth, internally generated discretionary cash flow and moderate leverage. All of this signifies staying power and even the ability to go on the offensive during difficult periods and take advantage of lesser competitors. This gets back to what I said earlier about being in a position where time works for us rather than against us.

With management, our focus as you mention is on adaptability. Anyone who is a keen observer of business and has run their own company, as I have, knows that conditions on the ground are constantly changing. So we spend a lot of time getting to know management and how they've reacted to both positive and negative periods in the past. Are they able to maintain focus on long-term measurable goals while executing through current conditions? This requires regular interaction – we don't believe we can truly know what is happening at a company unless we're in

Michael Cook

Natural Path

Having studied religion and philosophy at tiny Covenant College in Lookout Mountain, Georgia, Michael Cook first took a job as a broker in Chattanooga, Tennessee more out of curiosity than an expectation that finance was his life's calling. "It wasn't necessarily a natural path for me and I am an awful salesman," he says.

Drawn to business analysis, he parlayed that position into a buy-side job with a regional bank that a few years into his tenure – and following the 1987 market crash – cut back its investing ambitions and laid off most of its analysts. Faced with the prospect of moving his family, Cook instead set up his own firm in Memphis to manage his parents' money as more or less a stopgap measure. Twenty-seven years later his SouthernSun Asset Management manages approximately $5.4 billion.

Certain of his philanthropic efforts have also stayed close to home. His gift to the University of Memphis allowed it to open what was originally to be called a trading lab, outfitted with software and systems used by professionals. Consistent with his investment approach, he points out that the actual name is now the Cook Analytics & Trading Lab, "with more emphasis on the analytics than the trading," he says.

regular contact with the people running it at different levels. In terms of metrics, we want to see a record of increasing return on capital over time. That's typically a good measure of management's ability to allocate capital.

We've owned shares for some time in Darling International [DAR], whose traditional business is in recycling cow carcasses into animal-feed ingredients. When concerns over Mad Cow disease shrunk U.S. cattle herds, the company not only put significant emphasis on operating more efficiently, it also expanded outside its core business. It reconstitutes oils from the grease that comes out of traps in restaurant kitchens, and about two years ago entered into a joint venture with Valero Energy to produce renewable diesel fuel at a facility in Louisiana. It acquired a company that recycles commercial bakery leftovers. It's the largest producer and supplier of gelatin in China. The businesses can be cyclical and conditions now are less than positive, but the company still generates considerable cash flow. All of this is a great credit to [Chairman and CEO] Randy Stuewe and his team, who have done an excellent job in developing new opportunities while staying keenly focused on day-to-day execution.

How does something like farm-machinery manufacturer AGCO [AGCO], which is much smaller than competitors Deere and CNH Industrial, fit your niche-dominant profile?

MC: The niches here are primarily geographic, as AGCO is the #1 tractor producer in Western Europe as well as in South America, two areas that account for more than 50% of the company's total sales. We think management has been very smart in making bolt-on acquisitions to diversify the revenue base and position the company both to ride out down cycles and to benefit long term from increasing agricultural mechanization and higher protein consumption in developing markets. We also believe they've been innovative in developing in-cab, engine and emission-control technologies, much of that driven by the company's long experience in Western Europe, where machines have to navigate smaller, more-complex plots and where emissions regulations tend to lead rather than follow. This is another situation where we believe cyclical concerns, in this case around commodity prices and agriculture, may be causing the market to misjudge the business opportunity going forward.

ON VALUATION:

I don't look at anything other than discretionary cash flow in trying to fundamentally understand a business.

Give an example of something recently added to the portfolio and how it got on your radar screen.

MC: We recently took a position in our mutual fund portfolio in Ascent Capital [ASCMA], which is in the residential and commercial security-monitoring business. We've owned competitor ADT [ADT] since late 2013 and also owned Broadview Home Security, which was spun off from Brink's Company and later bought by Tyco. We believe we understand this business well, but the specific impetus for our interest was the collapse of Ascent's share price from nearly $90 less than two years ago to $40 earlier this year, and now to below $30.

There's a pervasive fear that telecom and cable companies are going to take over Ascent's traditional business, and that customer growth is going to dry up as people set up a few cameras around the house to keep track of what's going on. We basically think that the monitoring, response and customer-service aspects of what Ascent does is less susceptible to competitive threat than is generally assumed. Have you called your cable company recently for customer service? We also think Ascent has opportunities to increasingly provide home-automation and other services to their customers. Only time will tell how it plays out, but we're comfortable we're paying a price that can turn out to be quite opportunistic.

Describe your valuation discipline.

MC: My father and grandfather were in the construction business, so after my exposure to that I've never been comfortable looking at anything other than cash flow in trying to fundamentally understand a business. Over time I've refined that down to discretionary cash flow, what's left over after what we consider maintenance capital spending and dividends. It's not at all a trivial exercise, but we're trying to get at the actual cash that management will have to invest in things like new plant and equipment, acquisitions, paying down debt or buying back stock.

We'll model that discretionary cash flow over time and come at valuation in a variety of ways, including applying normalized multiples, doing a sum-of-the-parts analysis and discounting the future cash flows back to the present. We want to buy businesses whose shares we think in the next three to five years can go up at least 50%, and over five to seven years can go up at least 100%.

One of the last steps you list before being ready to buy is an assessment of "key drivers of the business." Haven't you at that point already worked through all that?

MC: Due diligence takes time and is an organic process within the team. We've obviously gone through the drivers of the business, but I've found it helpful at this last stage to formally lay out what the absolute key ones are and how we're going to track them. It's a gut check on whether we fully understand the business and the risks and is an opportunity after summing up six months of work for people to flag fundamental concerns.

Do you take full positions right away?

MC: When I was starting out, a friend of mine who had been very successful as an investor told me that he found it amazing that no matter how much due diligence he did, the skeletons often didn't come out of the closet until he had something at risk. I've always kept that to heart and typically will start out with a 1.5% to 2.5% position rather than what for us is a full 4.5% to 6% position. I think that's served us very well over time.

Only owning 20 to 30 stocks in your small-cap portfolio is quite concentrated, especially given the amount of assets you manage. What's the rationale for that?

MC: That's how we've done things since day one. The rationale is that I've just always wanted it to hurt when we're wrong, because we're going to learn and grow from that. At the same time, we want it to matter when we're right. Why own something if it doesn't really matter if you're right or wrong?

We try to come at it as we own one, why own two? If we own two, why own a third? You walk yourself up the ladder and it becomes a discipline to constantly evaluate whether something new provides a better opportunity than what you own. Reevaluating what you own is a very healthy exercise.

Do you trade much around your existing positions?

MC: Our annual target turnover is in the 20-40% range, so we're not jumping in and out of positions as a way to time the market. We do, however, believe we're pretty good at knowing what businesses are worth, so when the market overshoots on either side we try to take advantage.

To give one example, in the third quarter of last year we added Murphy USA [MUSA] to the portfolio. It's a filling station operator in the South and Midwest, with almost all of its sites located next to a Wal-Mart. That results in significantly higher fuel sales per station, and also provides them with a long runway for growth as they build out the relationship with Wal-Mart across the large number of stores, even in just the South and Midwest, that don't currently have filling stations.

You wouldn't necessarily think this would be a volatile stock, but since we bought it it's gone from around $50 to over $70 and back down almost to where it started. [*Note*: MUSA shares currently trade at around $55.] It appears to trade on how people are feeling about Wal-Mart, what's happening with renewable-fuel tax credits and what's happening with oil prices – all to a degree that we think is out of sync with the long-term prospects of the business. When the stock went up so fast we took some gains along the way, and we've added some shares back as the stock has come back down.

> **ON VALUATION:**
>
> **I don't look at anything other than discretionary cash flow in trying to fundamentally understand a business.**

You've spoken highly of Oxford Analytica, a U.K.-based research firm that helps you monitor macroeconomic risks. How do you use their input?

MC: OA provides us with a regular flow of information on all the big topics of the day – from the refugee problem in Europe, to the debt crisis in Greece, to the market upheaval in China – and unbiased analysis of the potential impacts on various industries. It's really never about getting expertise that allows us to make a prediction and trade – I've rarely found that to work – but more about helping us to test what we're seeing with our own eyes and to refine the questions we're asking our companies. We'll read about sovereign-debt issues in Brazil, for example, and go back to OA for insight on what impact that might have on agricultural finance and regulatory oversight, which then informs what we'll ask AGCO management. That might be an important line of questioning we wouldn't have offered up otherwise.

Walk through the broader investment thesis today for Knowles.

Elliot Cunningham: The business operates in two segments. Around 60% of revenue comes from mobile consumer electronics, where it is by far the largest supplier of microphones and among the top three suppliers of speakers and receivers. The rest of the business is in what they call specialty components, which includes hearing aids, where they are the global market leader and have been a technology pioneer for more than 60 years. It's a global company, with design centers in North America, Europe, Asia and India.

We believe the mobile consumer electronics business presents plenty of growth opportunity and we like that Knowles does business with most every original equipment manufacturer, typically brought in during the spec and design phase as new products are developed. Not only are smartphones becoming more and more ubiquitous, but the acoustic content per device is also increasing. In 2008 it was $1-2 per phone, now it's $2-3 and the trend is going toward $3-5. In the hearing-aid business there's a tailwind from aging populations, as well as the fact that hearing aids keep getting better and smaller, which should allow greater market penetration as many more of the people who can benefit from a hearing aid actually start to use them.

As Michael mentioned, Knowles in the latter half of last year identified a low-level product defect in one of the microphones that was going into the iPhone 6, causing it to pull out of production late in the game. The company is vertically integrated so as volumes fell, margins came down meaningfully, causing an estimated $70 million hit to revenues and $60 million hit to earnings before interest and taxes [EBIT]. That's what got our attention. We ended up adding the position in April of this year.

Losing the Apple business would obviously be a big negative, but it turns out the defect wasn't perceived as a chronic problem and Knowles technology is back on the Apple platform, both for the iPhone

6 line and other products under development. The defect was actually so inconsequential that the company has been able to sell much of the inventory it pulled to other OEMs.

Is technological obsolescence a bigger risk here than in your typical holding?

EC: We haven't historically had a lot of exposure to the tech space for that reason. Here we think the risk is mitigated by how dominant Knowles is in its markets. In the microphone business, for example, it controls approximately 60% of all global manufacturing capacity, so phone OEMs literally couldn't make enough phones without it. The company in our opinion has also done a great job in maintaining technology leadership for a very long time. An Apple or Samsung won't want a single supplier, but Knowles' involvement at the front end of the product-development process typically means it will get more than its fair share of the business. Finally, they do business with almost every viable OEM on the consumer side. So if a customer like Nokia or Blackberry struggles, another like Xiaomi typically picks up the slack.

The shares, at a recent $17.65, are down 30% in the past year. What upside do you see from here?

EC: We're looking for normal top-line growth in the 7% range, and as volumes through their factories recover we think margins will increase meaningfully. With the Apple problem, operating margins, adjusted for acquisition amortization charges and some restructuring, went negative in the mobile consumer electronics business last quarter. Management is targeting overall margins in the low-20% range, which the company earned as recently as 2013. We think they can get there again. If they do, coming at the valuation in a variety of ways, we believe the share price can double over the next couple of years.

Is the high short interest, above 30% of the float, a concern?

EC: It's certainly something we want to understand. The Apple issue will take a quarter or two to work through the system, so that may signal more of a red flag to some than we believe it really is. Beyond that there's probably also some knee-jerk concern about Chinese exposure that we don't believe impacts the long-term thesis. Finally, as a new public company, it's possible that management's credibility has been somewhat put into question, particularly after the Apple issue. It may take some time, but we're confident in the management team going forward – their history of operational execution has been very good.

Whatever the near-term ups and downs, Knowles has a conservative balance sheet and impressive cash-flow characteristics that give it all the flexibility it needs. Now it's all about execution.

What drew your attention to automotive-equipment supplier Tenneco [TEN]?

Michael Cross: This is a company we've followed for some time, but we decided to look more closely at it out of a conversation we were having, with Oxford

INVESTMENT SNAPSHOT

Knowles
(NYSE: KN)

Business: Global producer of acoustic products such as hearing aids and microphones, speakers and other products used in mobile consumer-electronics devices.

Share Information
(@9/29/15):

Price	**17.66**
52-Week Range	13.31 – 26.38
Dividend Yield	0.0%
Market Cap	$1.57 billion

Financials (TTM):

Revenue	$1.07 billion
Operating Profit Margin	0.4%
Net Profit Margin	(-4.5%)

Valuation Metrics
(@9/29/15):

	KN	Russell 2000
P/E (TTM)	n/a	81.7
Forward P/E (Est.)	14.6	17.0

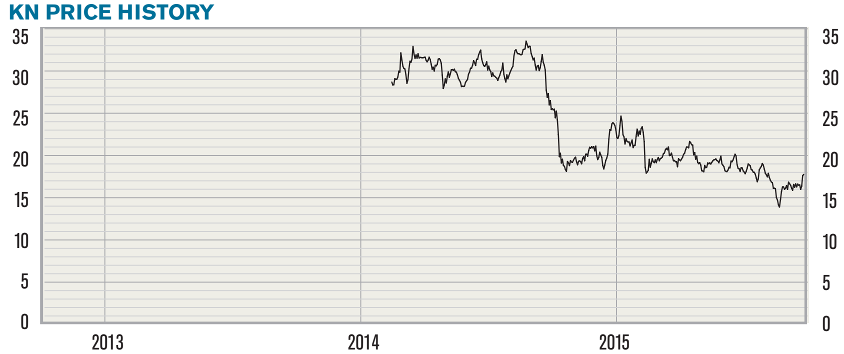
Largest Institutional Owners
(@6/30/15):

Company	% Owned
Shapiro Capital Mgmt	11.2%
Janus Capital Mgmt	10.5%
BlackRock	7.1%
Vanguard Group	6.4%
Sterling Capital	4.8%

Short Interest (as of 9/15/15):

Shares Short/Float	32.7%

KN PRICE HISTORY



THE BOTTOM LINE

While it's digging out from a manufacturing-related setback last year, the company is well positioned in two industries – mobile-phone acoustics and hearing aids – with attractive long-term prospects, says Elliott Cunningham. Assuming top-line growth around 7% and a rebound in margins, he believes the share price can double in the next couple of years.

Sources: Company reports, other publicly available information

Analytica's input, around the businesses that were well positioned to benefit from the pollution situation in China. One area that is likely to get increasing attention is vehicle emission control regulation, and emission control is Tenneco's primary business.

The company's clean-air division, which accounts for some 70% of revenues, packages catalytic exhaust systems and sells them to automotive, commercial-truck and off-highway vehicle OEMs around the world. Their scale allows them to be very competitive from a cost standpoint, they have strong and deep relationships with customers' engineering and design groups, and they understand the roadmap of emission-control regulations better than anyone. All that tends to create customer loyalty and puts up important barriers to competitive entry, which is highly valuable as increasingly stringent clean-air regulations are enacted, not just in China, but around the world. As Tenneco's technology addresses that, it should increase the dollar content of the company's products per vehicle.

The other big business is in ride performance, which primarily means shock absorbers like those sold under the Monroe name. Tenneco is a low-cost leader and also benefits from a nice, higher-margin and more stable aftermarket business. While there's not as much going on here from a technological standpoint, better shock absorbers improve the ride and handling characteristics of any vehicle, and are likely to become increasingly prevalent in more mainstream cars going forward. The company should be a key beneficiary of that.

In terms of financial flexibility, Tenneco has been a consistent generator of cash flow, which has been used to fund organic expansion, primarily in Asia, and to pay down debt. Current net debt to annual EBITDA is only around 1.3x. The board also recently approved a buyback of up to $350 million worth of shares, material for a company with just over $2.6 billion in market cap.

Already weak, the shares took a more recent hit from Volkswagen's admission to cheating on its emissions-control capabilities. How inexpensive do you consider the stock at today's $43.50 price?

Michael Cross: The company's direct exposure to VW's diesel cars is minimal, and we don't believe the scandal will negatively impact the drive globally toward stronger emission-control regulation.

Overall we're looking at 5-6% top-line growth, with some modest operating leverage taking margins a bit higher. Short-term there's concern about growth in Asia, which accounts for 15-20% of revenues and a higher percentage of profits, but as I mentioned earlier, we see China and the rest of Asia as a long-term growth driver. Over the next three years our valuation work puts the share price at closer to $70. Five years out we think that can be around $90.

This isn't necessarily an exciting business, but as someone who spent 24 years at Cummins [CMI] prior to joining SouthernSun, I've seen first-hand how evolving environmental regulations around cars and trucks can translate into profitable growth. The same dynamic should be a real tailwind for Tenneco.

INVESTMENT SNAPSHOT

Tenneco
(NYSE: TEN)

Business: Designs, manufactures and distributes emission-control and ride-control products and systems for vehicle original-equipment, repair and replacement markets.

Share Information
(@9/29/15):

Price	**43.50**
52-Week Range	39.13 – 61.73
Dividend Yield	0.0%
Market Cap	$2.64 billion

Financials (TTM):

Revenue	$8.24 billion
Operating Profit Margin	6.6%
Net Profit Margin	2.7%

Valuation Metrics
(@9/29/15):

	TEN	Russell 2000
P/E (TTM)	11.8	81.7
Forward P/E (Est.)	8.1	17.0

Largest Institutional Owners
(@6/30/15):

Company	% Owned
Fidelity Mgmt & Research	11.3%
Vanguard Group	6.2%
Robeco Inv Mgmt	5.4%
BlackRock	5.1%
SouthernSun Asset Mgmt	3.1%

Short Interest (as of 9/15/15):

Shares Short/Float	4.8%

TEN PRICE HISTORY

THE BOTTOM LINE

The company's scale, customer relationships and experience in navigating regulatory regimes should allow it to benefit from more-stringent regulations around vehicle emission control worldwide, says Michael Cross. Assuming mid-single-digit revenue growth and modest operating leverage, he values the shares within three years at around $70.

Sources: Company reports, other publicly available information

What's behind your interest in Hanesbrands [HBI]?

Peter Matthews: To give some history, the company was spun out of Sara Lee in 2006 with a significant amount of leverage and a disjointed and inefficient supply chain. It wasn't an easy fix, but management started to reconfigure the supply chain with an emphasis on owning and operating its own factories in low-cost areas in the Caribbean basin and in southeast Asia. There were clear obstacles from the financial crisis and then a sharp cotton-price rise in 2011, but by the time we bought into the company in 2013 it had built a world-class manufacturing and distribution capability and had the potential to take advantage of it by acquiring brands in its core underwear and activewear clothing markets. After integrating the acquired businesses, it typically ends up having paid ex-post EBITDA multiples of less than 5x.

The key brands like Hanes, Maidenform, Playtex and Champion generally sell across the retailer spectrum, from Macy's to Costco to Wal-Mart. These are usually the #1 or #2 brands in their categories and while price matters, they benefit from reputations for comfort, fit and consistency that enhance and reinforce customer loyalty. When cotton prices spiked in 2011, for example, Hanes had to put through three price increases to cover higher costs and they had little or no impact on sales. In fact, the company ended up increasing its shelf space at retailers like Wal-Mart during that period.

While the organic growth in Hanesbrands' end markets isn't particularly exciting, we believe it has a long growth runway in buying additional brands to plug into its system. Part of the upside in such deals comes from overall integration cost savings of 15-20%, but the company has also been willing to invest in new styling and things like better fabric technology to improve and refresh the acquired brands' product lines. That's had a positive impact recently on Maidenform, which was bought in 2013. They're now applying the same program – they call it "innovate to elevate" – to the Knights Apparel brands bought earlier this year to expand in the collegiate-logo apparel business.

How do you see this translating into good news for the shares, now trading at $28?

PM: It's interesting that the stock went down after the company announced last quarter that it was initiating a share-repurchase program. Management made the case that the business produces so much cash that they can pay a dividend, buy back shares and continue to make acquisitions as before. But that didn't sit well with the market, which seemed concerned that the buyback signaled a weaker pipeline for acquisitions than expected. We don't think that's the case, but we agree with the sentiment that acquisitions are a key element to the upside here.

The stock now trades at 15x consensus earnings estimates for next year. That to us signals a business with limited growth prospects and decent, steady cash flow. But we think this is much more, and that Hanesbrands has a fantastic recipe for value growth through acquisition. The market can be slow to value that on current numbers, but we'd argue that the company deserves the multiple of a high-quality

INVESTMENT SNAPSHOT

Hanesbrands
(NYSE: HBI)

Business: Design, manufacture and sale of men's and women's basic apparel, including underwear, socks and T-shirts sold under the Hanes and Champion brands.

Share Information
(@9/29/15):

Price	**28.03**
52-Week Range	24.93 – 34.80
Dividend Yield	1.4%
Market Cap	$11.28 billion

Financials (TTM):

Revenue	$5.65 billion
Operating Profit Margin	14.5%
Net Profit Margin	6.3%

Valuation Metrics
(@9/29/15):

	HBI	S&P 500
P/E (TTM)	32.2	20.6
Forward P/E (Est.)	15.0	16.4

Largest Institutional Owners
(@6/30/15):

Company	% Owned
T. Rowe Price	13.3%
Vanguard Group	8.4%
BlackRock	4.0%
State Street	3.8%
Barrow, Hanley, Mewhinney & Strauss	3.2%

Short Interest (as of 9/15/15):

Shares Short/Float	3.7%

HBI PRICE HISTORY

THE BOTTOM LINE

While the company has proven highly adept at acquiring new brands and integrating them into its top-notch manufacturing and distribution systems, the market is valuing it as if it has limited growth, says Peter Matthews. If it continues to grow through acquisition as he expects, he sees 50% upside for the shares over the next two to three years.

Sources: Company reports, other publicly available information

consumer packaged goods company like Colgate-Palmolive, which trades at 21x next year's estimates. With a re-rating and the cash-flow growth we expect, we think there's at least 50% upside in the stock over the next two to three years.

With Berkshire Hathaway and Greenlight Capital as large fellow shareholders, you're in good company in owning Chicago Bridge & Iron [CBI]. What you think others are missing?

PM: This is an engineering and construction firm primarily serving the energy, petrochemical, power and government-services industries. Specialties include natural gas liquefaction and regasification, nuclear power, pipe fabrication, and all manner of flat-bottom tanks used to store hydrocarbons and petrochemicals.

One current negative perception – and it is a headwind – is that the oil-price decline will put the brakes not just on upstream exploration and production projects, but also on a broader range of downstream infrastructure spending and in related areas like petrochemicals. There's also heightened concern around CBI's nuclear-plant business, as changing regulations have resulted in project delays and cost overruns. CBI has always maintained that it's protected by its contracts and won't get stuck having to pay for change orders, but uncertainty around that has also been weighing on the stock.

Our basic view is not that headwinds don't exist, but that the current miniscule valuation on the stock isn't warranted. The company still has a $30 billion backlog – more than two years' worth of revenues – that is highly diverse by geography and by end market. It also seems to get little credit for areas in which it has very strong market positions and bright future prospects. One is in building LNG-related infrastructure, an area we believe should have a tailwind for the next decade as producers in low-cost regions look to liquefy natural gas and export it to higher-cost regions. We also see value being driven in high-return tank, pipe-fabrication and technology-licensing businesses. The global oil-production footprint is constantly evolving – witness the shale-oil boom in the U.S. – and the infrastructure around that has to evolve as well. CBI is nicely positioned to benefit as that happens.

How do you rate management adaptability here?

PM: The CEO, Philip Asherman, has been in the position for nearly 10 years and has continued to broaden and diversify CBI's capabilities and revenue base while focusing on increasing cash flow over a long time horizon. The company's profitability over time demonstrates, among other things, his unwillingness to take uncompensated risk or bet the company on individual high-profile projects. We were also pleased to see Michael Taff take over as chief financial officer in April, having joined from Flowserve, which we also own and consider a first-class company.

At today's $37.30, the shares trade at only 6.6x next year's estimated earnings. How are you looking at valuation?

PM: The company is expected to earn around $5.75 per share this year, but on a

INVESTMENT SNAPSHOT

Chicago Bridge & Iron
(NYSE: CBI)

Business: Global provider of design, engineering, fabrication, procurement and construction services to the energy, petrochemical and natural-resource industries.

Share Information
(@9/29/15):

Price	**37.34**
52-Week Range	32.16 – 59.45
Dividend Yield	0.7%
Market Cap	$3.97 billion

Financials (TTM):

Revenue	$13.09 billion
Operating Profit Margin	8.3%
Net Profit Margin	4.7%

Valuation Metrics
(@9/29/15):

	CBI	S&P 500
P/E (TTM)	6.7	20.6
Forward P/E (Est.)	6.6	16.4

Largest Institutional Owners
(@6/30/15):

Company	% Owned
Berkshire Hathaway	8.8%
Greenlight Capital	6.3%
Vanguard Group	6.0%
SouthernSun Asset Mgmt	5.8%
BlackRock	3.1%

Short Interest (as of 9/15/15):

Shares Short/Float	15.7%

CBI PRICE HISTORY

THE BOTTOM LINE

Fixated on negative impacts to the company's businesses from low oil prices, the market isn't properly valuing the diversity of its operations by geography and end market, says Peter Matthews. Considerable uncertainty must first clear, he says, but at a more reasonable 14x his estimate of normalized earnings per share the stock would trade above $90.

Sources: Company reports, other publicly available information

normalized basis we believe that will be in the range of $6.50 to $7. Applying what we consider a reasonable 14x multiple to that would result in a share price above $90. We realize this won't happen until some of the uncertainty in many areas clears up.

A short report last year accused the company of accounting malfeasance. What is that all about?

PM: The thesis was that CBI inappropriately handled the purchase-price accounting of its 2013 acquisition of Shaw Group in order to mask ongoing problems with some of the contracts assumed in the deal. We respect management and have gone in detail with them through the accounting assumptions – we don't believe they've done anything wrong or inappropriate.

How does RV-maker Thor Industries [THO] match up with your investment criteria?

Michael Cross: Thor is one of the largest U.S. manufacturers of towable and fully motorized recreational vehicles, selling under such brands as Airstream, Keystone, Thor Motor Coach and Dutchmen. Its brands are generally #1 or #2 depending on the niche category, and they tend to have extremely strong relationships with the independent dealer network that sells the product. Particularly after the financial crisis, dealers want to partner with the biggest and best players, which has allowed Thor to consolidate its position with them.

We consider the company a poster child for financial flexibility, even though it competes in a cyclical market. It has no debt and uses a capital-light manufacturing model, basically operating as more of an assembler than a manufacturer. If orders drop off, it has flexible relationships with both suppliers and employees that allow it to downsize quickly. Not many manufacturing businesses could see their top line fall 40%, as it did here in 2009, and still remain profitable. The company, through ups and downs, has made money every year since 1980.

Management runs a decentralized operation, taking advantage of overall scale in sourcing, but leaving the bulk of the operating decisions to the individual brands. Out of 9,400 employees, only 45 or so are on the corporate staff. This setup has allowed it to make several successful bolt-on acquisitions that have either strengthened positions in certain niches of the market or opened new ones. They're even testing the model a bit by backward integrating through the May acquisition of Postle Aluminum, a supplier of aluminum components to the RV industry.

RV sales took a big hit in the recession. How well has the business recovered?

Michael Cross: Unit volumes in the industry peaked in 2006 at 383,000, a level the company expects will be exceeded for the first time next year. Annual growth in units has been running at around 9% over the past five years, and while management thinks Thor will grow faster, we're modeling 5% organic unit growth going forward. A lot of that has to do with demographics – retiring baby boomers should buy more RVs – but we also see potential in an increasing number of the large popu-

INVESTMENT SNAPSHOT

Thor Industries
(NYSE: THO)

Business: Manufactures and sells towable and motorized recreational vehicles under such brand names as Airstream, Keystone, CrossRoads and Thor Motor Coach.

Share Information
(@9/29/15):

Price	**51.32**
52-Week Range	49.03 – 64.65
Dividend Yield	2.1%
Market Cap	$2.69 billion

Financials (TTM):

Revenue	$4.01 billion
Operating Profit Margin	7.2%
Net Profit Margin	5.0%

Valuation Metrics
(@9/29/15):

	THO	Russell 2000
P/E (TTM)	13.7	81.7
Forward P/E (Est.)	10.7	17.0

Largest Institutional Owners
(@6/30/15):

Company	% Owned
SouthernSun Asset Mgmt	7.2%
Royce & Assoc	6.9%
Vanguard Group	5.8%
BlackRock	5.3%
Robeco Inv Mgmt	3.3%

Short Interest (as of 9/15/15):

Shares Short/Float	3.9%

THO PRICE HISTORY

THE BOTTOM LINE

A "poster child for financial flexibility" due to its strong balance sheet, capital-light manufacturing and flexible relationships with suppliers and employees, the company should prosper from demographically driven recreational-vehicle demand over time, says Michael Cross. He pegs fair value for the shares at $70-80 over the next two to three years.

Sources: Company reports, other publicly available information

lation of tent campers in North America trading up into RVs.

How attractive do you consider the shares at today's $51.30?

Michael Cross: With our assumption of 5% unit growth and some increase in average selling prices, our discretionary cash flow analysis yields an estimated share price over the next two to three years of roughly $70 on the downside and $80 on the upside.

One key will be the mix of sales in the industry between the high end and the low end. Thor plays across the spectrum, but tends to lag when the low end is relatively hot and outperforms when higher-priced models are selling. That mix is something we'll keep a close eye on.

You've written about the "tragedy of urgency" in the market, which surely is more prevalent today than when you started in 1989. Does that make things harder or easier?

MC: Evaluating businesses and valuing companies – the most important things we do – is pretty much the same despite the fact that time horizons have gotten shorter and more and more trading is automated. One thing that's probably a bit better for us is the opportunity created by greater share-price volatility. One thing that makes it more difficult, however, is how today's environment unnerves clients unnecessarily.

We're persistent philosophically and in the way we go through our process, but like the management in our companies, we ourselves always have to adapt. We can adapt to increased competition. We can adapt to increased volatility. We'll have a harder time shifting focus more toward near-term results. That wouldn't be in our or our clients' interest – our own money is right there with them. VII

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