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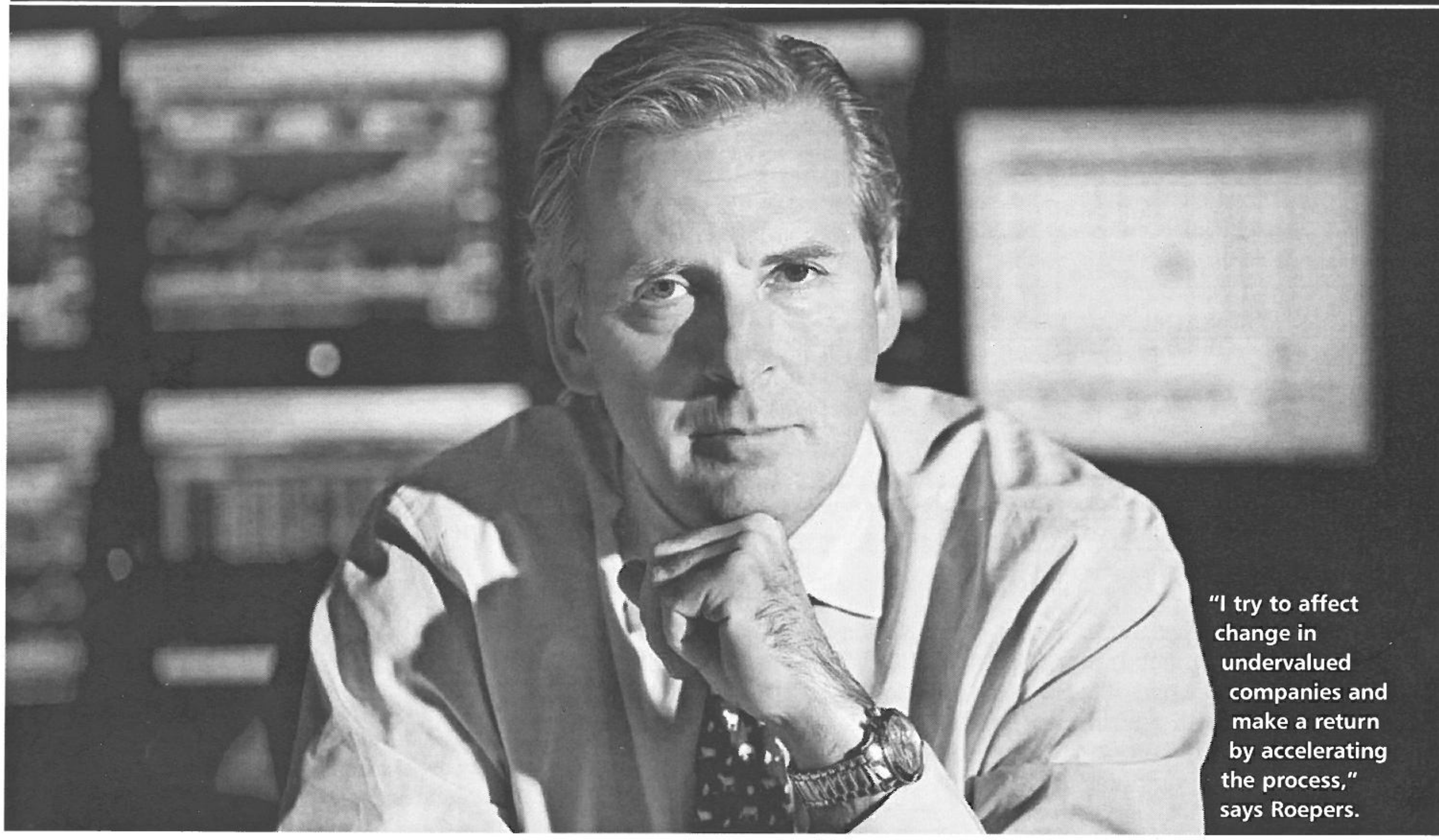

Gary Spector for Barron's

Talking With Alexander J. Roepers

Chief Investment Officer,
Atlantic Investment Management

Backstage Power

by Vito J. Racanelli

In New York City, successful activist investors are sometimes accorded rock-star status, but Alexander J. Roepers is much better known among his peers and clients than to the general public. That seems to be the way he likes it. Yet the hedge-fund manager's returns over the past two decades recall those of a more famous Dutchman, Peter Minuit, who, legend has it, bought Manhattan from the natives for 60 guilders worth of goods.

Roepers' Atlantic Investment Management's long-term track record is particularly impressive because the value investor buys big stakes – up to 7% of the shares outstanding – in a small number of mid-caps. With $1.6 billion under management and usually just a handful of names in his six individual funds, just one bad stock pick can sink returns for the year. His selections haven't been perfect, as 1998 and 2008 were tough years for the funds, but the performance speaks for itself.

His flagship hedge vehicles, AJR fund and Cambrian U.S. fund, both still open to new investment and unleveraged, have easily beaten the Standard and Poor's 500 index since inception. AJR has posted a 14% annualized total return from its start in 1993, compared with about 8% for the S&P 500. Long-only Cambrian U.S. has returned 21% a year since its 1992 beginning, versus the S&P 500's 8.4% annualized gain in that time.

"I try to affect change in undervalued companies and make a return by accelerating the process," says Roepers. By concentrating its capital on a few high-quality, undervalued mid-cap companies, Atlantic hopes to "make a difference as a constructively engaged shareholder," he says.

In other words, instead of running at companies with a pole axe like some headline-grabbing activists, Roepers prefers a pointer stick. Behind the scenes, he pokes, prods, makes suggestions, and occasionally, when necessary, gives a good shove, but rarely in public.

Roepers laughs at the "gentleman-activist" moniker that's often attached to him. "There is a spectrum of investor out there

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Only the Long-Term Returns Shout

Atlantic Investment Management has outperformed the market with a concentrated portfolio of large stakes in undervalued mid-cap companies, which it can agitate for shareholder-friendly changes.

	Total Annualized Returns			
	Last 12 Months*	3-Year	5-Year	Since Fund Inception
AJR fund	24.2%	-0.7%	4.5%	13.9%
Cambrian U.S. fund	33.3	-0.5	6.6	20.5
S&P 500 Index	15.3	-3.0	1.9	8.0/8.4**

Picks

Company/Ticker	Industry	Comment
Owens Illinois/OI	Glass maker	One of only two producers with worldwide reach; global economic rebound will help.
ITT Industries/ITT	Conglomerate	Out-of-favor defense stock with recurring revenue and low debt, selling at a 30% discount to the sum of its parts.
FMC/FMC	Specialty Chemicals	Gets 50% of earnings from agri-chemicals, and has a good position in lithium and soda ash.
Atos Origin/ATO.France	IT Services	Some 70% of revenue comes from long-term contracts with high renewal rates.
Prysmian/PRY.Italy	Electric/Telecom Cables	Fears that the company will spend too much on some acquisition caused a selloff. The stock is cheap.
Kurita Water Industries/6370.Japan	Water Treatment	Recurring and predictable high-margin businesses account for 80% of sales.

Pans

Vornado Realty Trust/VNO	Diversified REIT	Rising interest rates make this REIT less attractive.
Simon Property Group/SPG	Retail REIT	Ditto for this real-estate investment trust.

*Through Dec. 20, 2010. **Since 1993 for AJR and 1992 for Cambrian U.S.

Source: Atlantic Investment Management

from an index fund to Carl Icahn. I'm towards the activist side, but I stop short of activities that make me illiquid and where the dialogue with management is at stake," such as proxy battles or fights over board seats. "Everything before that, rattling the cage, meeting with management, writing letters, talking to other shareholders" is possible.

A little history helps explain the sectors that interest Roepers and the way he does things. The Hague-born 51-year old came to the U.S. after college for a Harvard MBA and then became a deal maker here at a very young age, mainly in industrial businesses.

At the time Holland's welfare state "didn't seem to reward hard work and entrepreneurship," he says. Since then, "it has gotten better [there]. It has gotten worse here," Roepers quips.

As a teenager he watched his father's competitors in the printing business get cheap government loans to conserve jobs and then "undercut my dad's business," which didn't rely on government assistance. The cold war was on. Russians tanks were only "a day and a half of driving [away]. . . . We stashed vodka under the floor and in the basement to have currency to trade."

In 1983, Roepers finished a Harvard semester on a Friday and began working Monday at conglomerate Dover Corp. By that afternoon he'd made a presentation to the CEO about Pathway Bellows, a California maker of flexible-expansion joints. "That same night I was on a flight to San Diego. Eight weeks later Dover bought Pathway . . . . Guess what? I'm a little psyched now about doing deals."

By the time he was 25, the Dutch polyglot – French and German in addition to English and his native language – was already elbow deep in such deals as the head of corporate development in the U.S. for another company. In four years, "I did an incredible number of deals," including the due diligence and valuation, as well as the structuring or restructuring of companies. That process led to his investment style at Atlantic, which considers industries "that you and I can understand and we can explain to our moms and dads."

That typically means packaging, aerospace, pumps and valves, industrial materials, specialty chemicals, information-technology services and food companies.

Roepers looks for stocks between $1 billion and $20 billion in market cap, with investment-grade balance sheets and low interest expense. He also seeks profitable companies with 10%-plus free-cash-flow yields, high barriers to entry and low insider ownership. His purchases sport enterprise value (market cap plus net debt) multiples of roughly five to six times future earnings before interest, taxes, depreciation and amortization, or Ebitda. The firm is especially interested in stocks where there's potential for an earnings turnaround or corporate restructuring.

As a result of its methodology, Atlantic not infrequently ends up in stocks that attract corporate takeover bids. Del Monte Foods (ticker: DLM), which last month agreed to be bought for $19 per share by Kohlberg, Kravis & Roberts, was a home run. Atlantic's average purchase price was $14.22, giving it a roughly 34% gain.

Among the firm's biggest positions right now is Owens-Illinois (OI), a glass and bottle maker, with an "unassailable franchise," the fund manager notes. Enjoying a monopoly or duopoly position in many of its end markets, Owens-Illinois trades at a 2012 EV/Ebidtda multiple of about 6.1, which doesn't take into account a possible upswing in demand. If developed economies start expanding again, "people drink more and up goes the demand. It's defensible and always profitable at a very low valuation," says Roepers.

Similarly cheap is defense conglomerate ITT (ITT), which was recently trading at 52 and has an enterprise value of about $10.3 billion. By Roepers' calculation, ITT's growing water and wastewater business is worth about $5.5-$6 billion and its motion-and-flow control units are worth another $2 billion. He values the defense business, based on a multiple of 6-7, at $4 billion to $5 billion. That puts ITT's fair value closer to $60-$70 a share. ITT has a strong balance sheet that should allow it to buy back shares and make acquisitions.

Roepers also likes FMC (FMC), a producer of agriculture-specialty chemicals, lithium and soda ash. All three areas are growing, have high barriers to entry, high net margins and are niche businesses. That also makes the company a takeover candidate. Based on earnings growth alone, he puts a $105 value on FMC, compared to today's 80.

In Europe, Atlantic owns Atos Origin (ATO.France), an IT-service company whose profit margins should improve as it cuts costs. It sells at a 2012 EV/Ebitda multiple of 4. Roepers is pushing new management to do an initial public offering of its growing high-speed payment-processing business, Worldline, to "unlock a lot of value at Atos." In the meantime the company has a clean balance sheet and can buy back shares. Atos hasn't responded positively to Roepers' IPO proposal as yet, "but it's out there," he says.

The IPO isn't necessary for the stock to rise, because it's a takeover candidate and the managers are under pressure to get the share price up, he adds.

Another favorite is Prysmian (PRY. Italy), a big player in high-voltage cable used in energy and telecoms globally. A recent drop in the stock price, now equivalent to 5.9 times 2012 EV/Ebitda, makes it an interesting play. Investors are upset that Prysmian could escalate a bidding war with a Chinese company over Dutch rival Draka. The fear is that the Italian company will bid too aggressively, making the deal dilutive to shareholders. Roepers believes that's a low probability. At the recent, lower price, the stock is a good value, he says. However, if Prysmian were to raise its bid, Atlantic would probably sell.

Roepers' pressure has borne fruit at Kurita Water Industries (6370.Japan), which Atlantic has owned at various times over the years. The Japanese supplier of ultra-pure water to semiconductor makers and others has lots of recurring revenue, he notes. "They know us and we started again banging on the door" about a share buyback program. Kurita recently announced a 2% buyback of its shares and the stock is up about 22% since. "They can buy a lot more shares," Roepers says, suggesting the company is capable of buying back as much as 30% of its stock next year.

In its short book, Atlantic focuses on richly valued companies with poor fundamentals, or accounting, debt and legal issues. The money manager is currently short REITs Vornado Realty Trust (VNO) and Simon Property Group (SPG), which specializes in retail shopping outlets and malls. The bet is based on a near-term sector valuation call, Roepers says, because the REITs' favorable yields will look less alluring as rates on other securities, like Treasury bonds, rise. The stocks, which have outperformed broad markets this year, are vulnerable.

While he's the sole principal at Atlantic, Roepers has got plenty of help, a 27-member team of analysts behind him. Indeed, the athletic Dutchman, who once captained top junior field hockey teams for his country and is a serious sailor, says his sports activities offer many lessons in team building. "There is an Atlantic system of doing things . . . but we are all on the ship together to make it work."

Maybe that's why Roepers doesn't care about being a rock star. Something tells us his clients don't either. ■