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ValueInvestor INSIGHT

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In and Outs

Adroitly trading around core positions requires sticking to a clear buy-and-sell discipline. Here's how Alexander Roepers has done just that in managing the dramatic share-price volatility in two of his favorite holdings.

The investment cases that Atlantic Investment Management's Alexander Roepers presented early last year (*VII*, February 28, 2007) for mining-equipment giant Joy Global and aerospace systems supplier Goodrich were strikingly similar. Each company was a global leader in high-barrier-to-entry markets that were benefiting from what he considered to be long-term secular tailwinds. Each earned a significant and growing share of its revenues from recurring and high-margin after-market sales and service, dampening historically sharp earnings cyclicality. And each was on sale, trading near the low end of the valuation range in which Roepers typically invests – an enterprise value of around 8x forward estimated earnings before interest and taxes [EBIT].

For a time, the theses for both Joy Global and Goodrich played out beautifully for investors. As coal, copper and iron ore prices took off, Joy added to its already burgeoning backlog and the market's favor shone brightly on the company's shares. From a price of around $50 at the time of Roepers' initial interview, Joy's shares went as high as $90 in June of this year.

For Goodrich, rapidly growing global demand for new aircraft fueled a similar rise in the company's fortunes and share price. As the company significantly outpaced consensus earnings estimates, its shares reached $75 last December, up from $49 when Roepers first recommended them.

What the market giveth, however, it

INVESTMENT SNAPSHOT

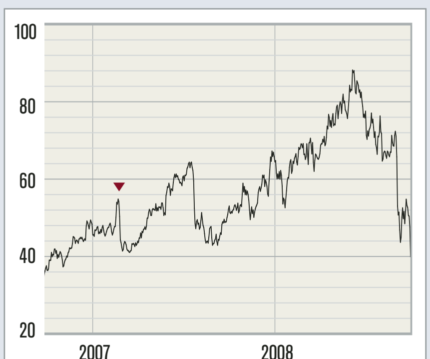
Navigating Choppy Waters

The long-term investment theses for Joy Global and Goodrich have changed little since Alex Roepers recommended them 18 months ago, while their share prices are down in line with the market. Managing each position, however, has been anything but boring.

Joy Global
(Nasdaq: JOYG)

Share Information (@ 9/29/08):

Price	**39.93**
52-Week Range	35.82 – 90.00
Dividend Yield	1.5%
Market Cap	$4.30 billion



▼ *VII* Interview, February 28, 2007

Original Thesis: With leading market positions and increasing after-market revenue, the company was well-positioned to benefit from a powerful long-term commodity cycle.

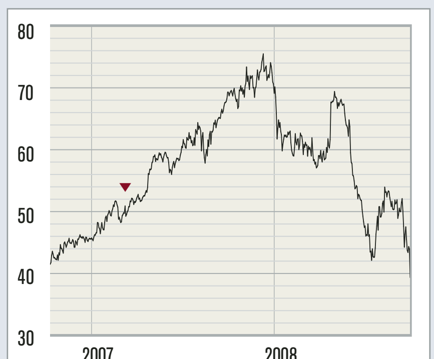
What's Happened: The company did capitalize on rising coal, iron-ore and copper prices until those prices – and Joy's stock price – fell of a cliff in late summer.

Response: Traded around the position as shares vacillated between the low-$40s and mid-$70s. Again building a new position as the long-term thesis remains intact.

Goodrich
(NYSE: GR)

Share Information (@ 9/29/08):

Price	**39.35**
52-Week Range	39.08 – 75.74
Dividend Yield	2.0%
Market Cap	$4.92 billion



▼ *VII* Interview, February 28, 2007

Original Thesis: A booming long-term aerospace cycle and increasing operating leverage would drive earnings growth well beyond what the market was expecting.

What's Happened: After reporting "blow-out" earnings, fears that high fuel prices and a slowing global economy would hurt aircraft spending have slammed the stock.

Response: Sold part of the position in the mid-$70s, more than buying it back as the price has fallen sharply. Calls valuation at 6.2x EV/EBIT a "gift from the heavens."

can also taketh away – fast. When commodity prices started to reverse course, Joy's share price sank like a stone, falling by more than 50% in 90 days. Following the House's rejection of the U.S. financial-bailout plan, spooked investors have taken the shares below $40. In Goodrich's case, escalating fuel prices initially sent its shares tumbling, but the pessimistic case has now shifted to a weakening global economy and the impact it will have on demand for new and refurbished aircraft. At a recent $39.35, Goodrich shares are down nearly 50% from their December high.

How has Roepers responded to all this? Had he sat tight with each holding since February 2007, his Joy Global holding would sport a 21% loss, while his position in Goodrich would be down 19% – both in line with the market's overall performance since then. But Roepers has done anything but sit tight with either of these holdings. In fact, his handling of each position makes a solid case for the benefits of actively trading around core positions, especially when market sentiment can vacillate as wildly as it has since the credit crisis began. His efforts also highlight the importance of having – and sticking with – a clearly defined buy-and-sell discipline.

In the case of Joy Global, two of Roepers' core portfolio management guidelines – one related to position size and the other based on valuation – have helped him earn much better returns from the company's shares than if he'd done nothing. When the share price went above $65 in the summer of 2007, he sold roughly one-sixth of the overall position to keep it at the maximum 15% of the portfolio he allows. Twice more in the following six months he traded that trimmed piece for the same reason, buying it back when the shares reached the mid-$40s and selling it when they returned to the mid-$60s.

ON MANAGING POSITIONS:

There is a solid case for active trading around positions, especially when market sentiment can vacillate so wildly.

When the share price climbed further to the mid-$70s in April, he sold his entire position because the valuation had come to exceed the 12x EV/EBIT upper-end target he'd set for the stock. "We've learned not to get greedy," says Roepers. "When it went beyond our high-end target, we were out."

Not for long, as it turns out. After Joy shares plunged this summer, Roepers started building a new position in it as the share price reached the mid-$40s. He accepts that Joy faces near-term demand challenges as commodity prices self-correct, but his original thesis – based on the company's dominant market position, rock-solid balance sheet, diversified revenue base and secular end-market growth – remains fully intact. As the market recognizes Joy's inherent strengths, he believes the shares can return to the 12x EV/EBIT multiple they earned earlier this year. On his 2009 estimate of $6.50 in EBIT per share, that would translate into a share price of $78.

Roepers' timing with Goodrich hasn't yet proven so propitious. He only got 25% of his stake sold when the share price hit his mid-$70s target based on valuation near the end of last year. As the stock fell, he bought that portion back after the price fell below $60 in March and has continued to buy on further weakness, betting that any slowdown in global aerospace spending will be relatively short-lived and that the company's earnings won't prove to be nearly as cyclical as the market appears to fear.

On an enterprise-value basis, Goodrich shares currently trade for only 6.2x the $1.1 billion in EBIT that Roepers expects the company to earn next year. "We believe there is a lot of visibility here and that the business model is far more resilient than the share price would indicate," he says. "The current multiple is a gift from the heavens." His target for the shares 12-18 months out: $75-80. VII