July 29, 2016

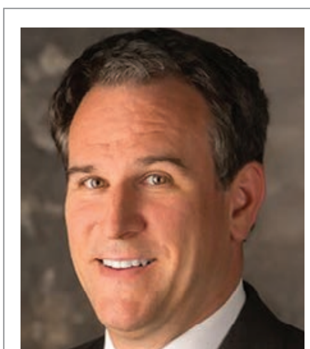
Value Investor INSIGHT

The Leading Authority on Value Investing

The Bright Side

Managed Asset Portfolios' Michael Dzialo exhibits the unique optimism-wrapped-in-pessimism found in many value investors. After reciting a number of global macroeconomic challenges – including a U.S. presidential election where "the only happy people are skit writers for *Saturday Night Live*" – he concludes: "The script is written for a lot of uncertainty, which often lends itself to volatility. That works in value investors' favor."

He's proven skilled at taking what the market gives. His Global Equity strategy since inception in 2001 has earned a net annualized 9.4%, vs. 5.6% for the MSCI ACWI Index. Areas on his value radar today include media and entertainment, agribusiness and liquor.



Michael Dzialo
Managed Asset Portfolios

Map Global Equity

Strategy Goal – long-term growth of capital by investing in a diversified equity portfolio

Style – Value

Market Capitalization Allocation – Large, Mid & Small

Stated Benchmark – MSCI All Country World Index

Investable Universe – Approximately 14,000 to 15,000 securities

Typical # of Positions Held – 40 to 65

Portfolio Construction Process – Bottom-up, based on fundamentals

Currency Hedging – None

Derivative Use – Select use of covered calls, or none if requested

Risk Management

Emerging Market Equity Exposure – Maximum 30%

Maximum Invest in a single non-U.S. country – 30%

Maximum amount invested outside the U.S. – 60%

Small-cap securities – limited to 2.5% (at cost)

Large-cap securities – limited to 5% (at cost)

Inside this Issue

FEATURES

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Playing off global uncertainty to find unrecognized value both near and far, in Bunge, C&C Group, GrainCorp and Vivendi.

Investor Insight: Metropolis
Seeking out less-than-obvious long-term business quality and finding it today in Ryanair, Regus, Rolls Royce and Halfords.

Investor Insight: Matthew Drapkin
Targeting overlooked small caps that are driving – or in need of – change, including Intevac, PRGX, Hudson and XO Group.

A Fresh Look: Linde
Assessing whether recent performance "lumpiness" is a red flag or a new buying opportunity.

Uncovering Value: Scripps
How insulated is this hearth-and-home programmer from upheaval in television distribution?

INVESTMENT HIGHLIGHTS

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Other companies in this issue:
Barnes & Noble, Bob Evans Farms, Cable One, DHX Media, Glu Mobile, GrainCorp, Headlam, Johnson & Johnson, Rolls Royce, Ruby Tuesday, Volkswagen

Investor Insight: Michael Dzialo

Managed Assets Portfolios' Michael Dzialo, Karen Culver and Peter Swan explain the thematic filters they're using today to identify opportunity and avoid trouble, why they aren't biting in beaten-down emerging markets, why they think value investing is poised to get its mojo back, and why they see unrecognized value in Bunge, Vivendi and C&C Group.

You have a largely unconstrained global strategy with what you call a 15,000-stock opportunity set. How do you winnow the good from the bad?

Michael Dzialo: The first part of the process is fairly mechanical, screening out companies based in countries in which we choose not to invest. We've never invested in China, for example, largely because we're not comfortable with the level of transparency. One of our clients is a former top executive at Chrysler and he says that for years when it owned a 51% stake in Beijing Jeep it could never get a proper audit done, including one time when an audit team was met at the door by two armed guards and asked to leave. Two years ago a law was passed saying that only Chinese nationals could sign off on audits of Chinese companies. We want to know our companies inside and out, which we don't think we can do in a place like China. We won't invest in Russia or Brazil, where government involvement in the private sector is unpredictable and sometimes hostile. We won't invest in frontier markets like Vietnam, which might otherwise be attractive but don't have the level of liquidity we're looking for.

The second cut is based on valuation, using typical metrics like low price/sales, low price/book, low price/cash flow and high dividend yield. We will invest in turnarounds that have what we consider artificially high P/Es, but only if other valuation measures are attractive. After this step in the process our universe is typically closer to 5,000 names.

Even though we're bottom-up stock pickers, we winnow the list next through a number of thematic filters. This is important because it directs us toward or away from different sectors, while keeping us from going for the head fakes you often get from typical value screens. As an example, in the first part of 2015 our screens were overrun with energy ideas. Here our overlay was that the laws of supply and demand work and that there was an imbalance in the energy market that we expected to take some time to work out. These more top-down filters can keep us out of trouble – many times what you don't own is probably more important than what you do own.

ON TOP-DOWN THEMES:

We're very overweight sectors that we think can do well in a weak-economic-growth environment.

What themes are behind your portfolio decisions today?

MD: The biggest one, which has been in place for a while, is that we're not in a typical economic cycle. Historically, exiting a recession the U.S. economy grows annually at 4-5%. This time we've had QE1, QE2, QE3, Operation Twist, the extension of Operation Twist, TARP, cash for clunkers and other efforts – all of which has produced 2.25% average annual GDP growth since the third quarter of 2009.

We think there are two structural issues that continue to create economic headwinds: an excess amount of debt in the system and a shift in employment demographics. Total domestic debt in the U.S. (federal, municipal, corporate and consumer) stands at roughly 330% of GDP, more than twice the level a half-century ago. There's excess debt in Europe, in Japan, in China, so it's clearly a global issue.

At the same time, developed nations like the U.S. have seen a major shift in their employment bases. Fifty years ago America's largest private-sector employers were companies like General Motors, Ford, Chrysler, Westinghouse, General Electric and U.S. Steel. Today it's Wal-Mart, Kelly Services (the temp-services company), Target, Kroger, Home Depot and Yum Brands. That shift from high-paying manufacturing jobs with great benefits to lower-paying service jobs with few benefits has put a real squeeze on the middle class and has limited their discretionary spending.

Given this state of the world, we're very overweight sectors – like food, beverages, tobacco and healthcare – that we think can do well in a weak-economic-growth environment. If we were expecting more growth, we'd be overweight in materials, manufacturing, chemicals and financials, sectors that do well in a more robust economic environment. That's just not what we see in the cards.

Another theme you've written about is the expansion of the middle class in emerging markets. How does that show up in the portfolio?

Peter Swan: The composition there has changed. In 2012-13 we were significantly overweight actual emerging-market companies, but today they make up maybe 5% of the portfolio. As Michael said, we're heavily tilted toward consumer staples and healthcare, and we're just finding more attractive valuations in large multinationals that benefit from expanding middle classes in emerging markets than in smaller companies in the emerging markets themselves. As an example, in tobacco we find an Imperial Brands [IMB:LN] or a Swedish Match [SWMA:SS] in Europe more attractive than, say, Sampoerna [HMSP:IJ] in Indonesia.

What's an example of a stock you own supported by your "squeeze on the middle class" theme in developed countries?

Karen Culver: That's not the only aspect of the thesis, but Bob Evans Farms [BOBE], the lower-end U.S. family-restaurant chain that also has a grocery-staples business, is a good example. The average ticket in the restaurants is below those of most full-service competitors, a positive in an environment where we expect discretionary consumer spending to be tight. We also believe the market isn't correctly valuing the company's food division, which produces homestyle sausages, soups, sauces and gravies sold in grocery stores. Based on where similar packaged-foods businesses currently trade, this piece of the business could be worth more than $850 million, which exceeds the current market value of the entire company by about 15%.

Coming back to the winnowing process for new ideas, what are the next cuts after passing the thematic filters?

MD: At this point we're down to maybe 1,000 names and here we'll start more fundamental research into individual companies' industry dynamics, profitability drivers, operating efficacy and management strength – all focused on identifying higher-quality businesses with staying power. After this step, at any given time we'll have 200 to 300 stocks that we consider our watch list.

The final step, meant to guard against value traps, is to identify specific catalysts that can unlock the value we see. It might be new management or a new product cycle. It could be the buying or selling of a division. It could be the arrival of a shareholder activist. Karen mentioned Bob Evans Farms. There not only is the sale of the food business a potential catalyst, but there's also an activist investor, Sandell Asset Management, agitating for change. The more distinct the potential catalyst, the better.

Describe the investment thesis, and potential catalysts, behind your interest in agribusiness company Bunge [BG].

KC: Bunge is a farm-to-table business, buying crops from farmers and then transporting, storing and, in many cases, processing them before sale to food and feed companies.

This is a cyclical business which by and large is in a negative part of the cycle, something we think is more than fully priced into the stock. But the long-term prospects for selling food commodities such as wheat, corn and soybeans are positive, as the overall population expands and people in emerging markets improve and diversify their diets.

More specific to Bunge, it has an opportunity to upgrade its business overall by selling higher-value-add products in response to consumer demand. To give one representative example, the company is a leading producer of edible oils. It developed a patented process to remove a particular acid from vegetable oils that lowers the oils' cholesterol content. The byproduct of that process can then be sold to makers of soaps and cosmetics. This dynamic is not dissimilar to what we expected to play out – and has – at Ingredion [INGR] when we spoke a few years ago [*VII*, January 31, 2014]. With Bunge, the value-add portion of the portfolio last year was about 15% and their goal is to get that to 35% going forward. That

INVESTMENT SNAPSHOT

Bunge
(NYSE: BG)

Business: Commodity-food conglomerate operating in five business segments: Agribusiness, Sugar & Bioenergy, Edible Oil Products, Milling Products and Fertilizer.

Share Information (@7/28/16):

Price	**65.35**
52-Week Range	46.08 – 82.79
Dividend Yield	2.6%
Market Cap	$8.57 billion

Financials (TTM):

Revenue	$41.56 billion
Operating Profit Margin	2.9%
Net Profit Margin	1.8%

Valuation Metrics
(@7/28/16):

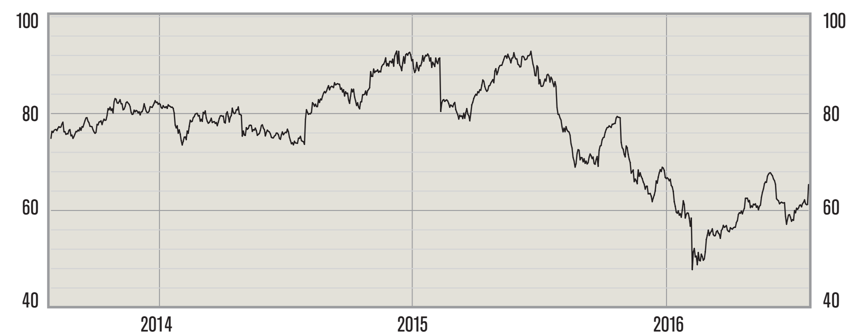
	BG	S&P 500
P/E (TTM)	13.8	24.9
Forward P/E (Est.)	10.8	18.4

Largest Institutional Owners
(@3/31/16):

Company	% Owned
Vanguard Group	8.7%
T. Rowe Price	4.3%
Franklin Templeton	4.1%
BlackRock	3.7%
Harding Loevner	3.3%

Short Interest (as of 7/15/16):

Shares Short/Float	1.7%



THE BOTTOM LINE

Taking from the playbook of smaller competitors like Ingredion, the company has considerable potential to upgrade its overall business by shifting sales to more value-added products that meet changing consumer demands for food, says Karen Culver. If it hits its profit goals, using today's low valuation levels, the shares would trade well over $110.

Sources: Company reports, other publicly available information

would have a significant impact on long-term profitability.

Another potential catalyst we see involves the company's large commodity sugar business. Bunge doesn't consider sugar core to its long-term strategy, so it has announced its interest in selling the business, which after considerable cost cutting in recent years has improved its performance. Assuming they use the proceeds of any sale to buy back shares, we would expect it to be accretive to earnings.

How are you looking at valuation with the shares now trading at $65.35?

KC: The stock trades at less than 14x trailing earnings and only 11x forward earnings. That compares with an average P/E over the past five years of 14x and a high during that period of 21x. Peers are more expensive: Archer Daniels Midland trades at more than 17x trailing earnings. Ingredion is at nearly 22x.

Using consensus 2017 estimates of just over $6 in EPS, with no change in trailing P/E the stock would trade at around $83. The company believes it can get to $8.50 or so in earnings in the next few years. If they can get close to that, which we consider a fair assumption, even with no valuation adjustment the shares would trade well over $110. If the stock re-rates, the upside is much higher.

Ingredion, at around $62 when we last spoke, now trades at $133. Do you still hold it?

KC: We got out earlier this year as the P/E went over 20x and we concluded most of the upside from new products and adding value to existing products had been realized. We weren't necessarily looking for a replacement to buy in the sector, but we actually did end up redirecting much of the sale proceeds into Bunge.

Since you have a lot of credibility with us on the subject of food processors, we should ask as well about your position in GrainCorp [GNC:AU], the large Australian grain merchant.

PS: This idea is more catalyst driven than anything else. Archer Daniels Midland made a takeover offer for the company in April of 2013 at A$12.20 per share, but it was blocked by the Australian government as not being in the interest of stakeholders and the broader community. ADM had a 20% stake at the time, which it has continued to hold. The catalyst is that there has been an administration change in Australia and we believe the new regime is more likely to look favorably on a reprise of the deal. The buy rationale still makes sense for ADM, and the strength of the U.S. dollar against the Australian dollar would probably make it even easier. It's hard to say when, but we expect a deal to eventually get done. [*Note*: GrainCorp shares traded recently at A$8.10.]

Shifting to Europe, explain your investment thesis for France's Vivendi [VIV:FP].

PS: Under the direction of Vincent Bolloré, a well-known European activist investor who owns approximately 15% of the shares, the company has gone through a significant transformation that has left it with two major operating units, Universal Music Group and French pay-TV company Canal+, and a balance sheet that went from heavily levered to having €4.8 billion in net cash.

You don't generally hear a lot of enthusiasm for the music business, but Universal Music generated €600 million in annual EBITDA last year – more than half the company total – and we think is at an inflection point where the digital side

INVESTMENT SNAPSHOT

Vivendi
(Paris: VIV:FP)

Business: Diversified global producer of media and entertainment, with primary focus on music (Universal), pay television (Canal+), and TV and film production (Studiocanal).

Share Information
(@7/28/16, Exchange Rate: $1 = €0.9022):

Price	**€17.61**
52-Week Range	€14.87 – €24.65
Dividend Yield	5.7%
Market Cap	€22.57 billion

Financials (2015):

Revenue	€10.76 billion
Operating Profit Margin	9.9%
Net Profit Margin	6.5%

Valuation Metrics
(@7/28/16):

	VIV:FP	S&P 500
P/E (TTM)	15.1	24.9
Forward P/E (Est.)	27.9	18.4

THE BOTTOM LINE
The company, now under the direction of successful activist investor Vincent Bolloré, is taking steps to capitalize on its leading positions in global music and European pay TV, while also developing other media "irons in the fire" that can create substantial shareholder value, says Peter Swan. His current sum-of-the-parts value for the shares: €22-23.

Sources: Company reports, other publicly available information

of the business grows enough to drive the overall top and bottom lines. It also as the worldwide market-share leader in recorded music is well positioned to expand in emerging markets. Right now 75% of UMG's revenues come from only five countries, which indicates to us there's plenty of room to grow elsewhere.

Pay-TV in France has the challenge of new competitors like Netflix and Amazon and old competitors like Sky, but we believe the company is doing the right things in a variety of ways to improve the customer experience while at the same time offering more intelligent and competitive pricing options. Canal+ also owns Studiocanal, Europe's biggest film studio, which we consider a key asset in an environment where more and more people are bidding up prices for media content.

One knock on the company is that it's showing signs of re-conglomerating after de-conglomerating so aggressively. Is that a concern?

PS: The deals haven't been enormous, but the company has been adding assets to the portfolio, including stakes in game companies Ubisoft and Gameloft, as well as in Dailymotion, which is the French YouTube. Our view is that if you're in the media-content business you should have a number of irons in the fire that by themselves can generate considerable value, but that also when combined with other things you do can make you a stronger competitor. We'd argue these acquisitions can contribute to both of those goals.

How do you arrive at what you think the shares, now just over €17.60, are worth?

PS: We use a straightforward sum-of-parts valuation. We think Universal Music is worth around €10.2 billion, or 2x sales. At 1.5x sales – similar to where Sky, which is more levered, trades – we think Canal+ is worth another €8.2 billion. The portfolio of investment businesses and other assets – based primarily on prices at which they were bought, which should be relatively conservative – is worth maybe €6 billion. Add in €4.8 billion in net cash and we come to a current estimated share value of €22-23 per share.

It's not a small part of our thesis that Vincent Bolloré is calling the shots here. He sees this as his media holding company, and given our positive experiences investing with him in the past, we expect him to make the right calls on both the operating and capital-allocation fronts to create a lot of shareholder value.

Is your interest in Dublin-based C&C Group [GCC:ID] at all Brexit related?

PS: We owned the shares before, but they did get more interesting after the vote, falling about 20%. That decline really had nothing to do with concerns over unit volumes or market shares, the things that matter most to us, but was primarily a worry over the earnings impact on C&C given that they report in euros and nearly 50% of their business is done in the British pound, which fell on the Brexit news. This is the type of case where we ask if the long-term opportunity is still intact, and we think it is.

The company manufactures, markets and distributes branded alcoholic ciders and beers. Its core markets are England, Wales, Ireland and Scotland and it also has a nicely growing export business, where it is signing on a number of new distribution partners around the world. In ciders it owns some of the most recognizable brands in the space, including Magners, Bulmers and Woodchuck. Its main

INVESTMENT SNAPSHOT

C&C Group
(Dublin: GCC:ID)

Business: Dublin, Ireland-based producer, marketer and distributor of branded hard cider, beer, wine, soft drinks and bottled water sold primarily in the United Kingdom.

Share Information
(@7/28/16, Exchange Rate: $1 = €0.9022):

Price	**€3.75**
52-Week Range	€3.33 – €4.24
Dividend Yield	3.6%
Market Cap	€1.19 billion

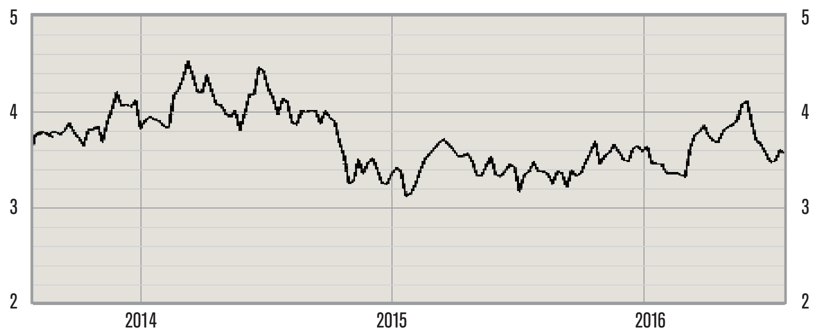
Financials (FY ending 2/29/16):

Net Revenue	€662.6 million
Operating Profit Margin	9.8%
Net Profit Margin	7.1%

Valuation Metrics
(@7/28/16):

	GCC:ID	S&P 500
P/E (TTM)	26.2	24.9
Forward P/E (Est.)	14.4	18.4

GCC:ID PRICE HISTORY



THE BOTTOM LINE
With excellent cash flow, strong "nichey" alcoholic-beverage brands and a rock-solid balance sheet, the company is a good candidate to create shareholder value through M&A, says Peter Swan, either as a buyer or a seller. In a takeout scenario, based on multiples paid for comparable companies, he believes the stock would be worth closer to €5.50.

Sources: Company reports, other publicly available information

beer, Tennent's, is brewed in Scotland, and the company also has rights to distribute other brands, like Corona, in certain of its markets. C&C has also had good success with new craft-style beers, especially a Belgian-style one called Heverlee.

This is the type of business we've been talking about that should do reasonably well in pretty much any economic environment. It generates a considerable amount of free cash flow – €113 million in the latest fiscal year on €663 million in net revenue – and management has done a good job balancing the investment needs of the business with returning capital to shareholders. They've bought back a lot of stock and have increased the dividend at a 14% annual rate over the past five years. We also like that the balance sheet is rock solid, with net debt around 1.3x annual EBITDA.

We think the catalyst here will be around M&A. The company has expressed interest in acquiring beer brands in the U.K., which at the right price we think would make a lot of strategic sense. Some brands may come up for sale as a result of the Anheuser-Busch InBev/SABMiller merger, and Carlsberg has expressed interest in exiting the U.K. market.

We also believe C&C, with its strong brands and good market positions, would make an ideal acquisition candidate. The hard-cider business is a bit nichey for larger brewers to make a big effort at organic growth, but we think they would be very interested in an already established, highly profitable player in the space whose stock is relatively cheap.

How cheap do you consider the stock at a recent €3.75?

PS: The stock currently trades at 1.8x sales and at 14.4x 2017 estimated earnings per share of 26 euro cents. We think the shares deserve to be re-rated, and even at 17x earnings they would trade at a discount to much-larger peers. In a takeout they could command between 2.5x to 3x sales, which would result in a share price closer to €5.50. To give some perspective, Molson Coors trades at around 5.4x sales. A-B InBev is at 4.7x sales.

Have you been suffering at all from the value-investor blues that seem to have afflicted a lot of people we speak with?

MD: With much of 2014 and 2015 marked by the outperformance of growth over value, we did a paper late last year trying to better understand what was going on. If you owned the stocks in the lowest quartile of valuation in the S&P 500 last year, you were down 15%. If you owned the highest quartile in valuation, you were up 12%. The gap hadn't been that large since 1999, the height of the Internet bubble. We know how that chapter ended for growth investors.

We actually think value started to get its mojo back early this year, which was one of the rockiest openings to a year in stock-market history. Value tends to outperform in periods of volatility. Given all the broad-based macro risks we see in the world, we expect that to result in heightened uncertainty and greater volatility. I don't know how to invest otherwise, but value investors should acquit themselves well if that turns out to be true. VII

Investment Team and Process

Michael S. Dzialo
Founder, President & Chief Investment Officer
29+ Yrs. Investment Experience

Peter J. Swan
Portfolio Manager & International Equities Analyst
24+ Yrs. Investment Experience

Karen M. Culver
Senior Portfolio Manager
25+ Yrs. Investment Experience

Quantitative Screening

Value Drives our Search Process – What is the Definition of Value?

From approx. 15,000 to approx. 5,000

Developing Global Themes

Focus on the Structural – And Avoid the Noise (Cyclical)

From approx. 5,000 to approx. 1,000

Conducting Fundamental Research

Buy Good Businesses

From approx. 1,000 to approx. 200

Identifying Catalysts for Change

Don't Get Caught in the Value Trap

From 200 to approx. 40-65

Portfolio Construction

Have Conviction

40-65 securities

Disclosure

Data is as of the date mentioned above and has been obtained from sources which we deem reliable but are in no way guaranteed by us as to their accuracy. The information contained herein represents our findings as the date mentioned above. Our review of the securities above is provided as a representation of our investment process. We are not obligated to update you as to any change in figures or our views. Past performance is no guarantee of future results.