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ValueInvestor INSIGHT

The Leading Authority on Value Investing

Strength in Numbers

The overall quality of corporate earnings is high, says Bob Olstein, but the market's ability to ascribe value to those earnings is as prone to error as ever.

INVESTOR INSIGHT

Robert Olstein
Olstein Capital Management

Investment Focus: Seeks companies whose reported financials and stock prices don't reflect true earnings power for identifiable, quantifiable and correctable reasons.

A forensic-accounting pioneer – he co-founded the avidly followed *Quality of Earnings Report* in 1971 – Robert Olstein's preference for cash flow statements over conference calls remains fully intact. "Better to spend one night with a company's financial statements than two days with its management," he says.

Keeping his nose in the books has paid off handsomely. Since founding Olstein Capital Management in 1995, his All Cap Value Fund has earned a net average 10.0% per year, vs. 7.5% for the Russell 3000.

Investors' shrinking time horizons "set things up nicely for value investors today," says Olstein, who sees opportunity in such areas as industrial supplies, automotive electronics, theft-prevention systems, microprocessors and soft drinks. See page 11

The performance data quoted represents past performance and does not guarantee future results. The Olstein All Cap Value Fund's Class C average annual return for the one-year, five-year, and ten-year periods ended 03/31/13, assuming reinvestment of dividends and capital gain distributions and deduction of the Olstein All Cap Value Fund's maximum CDSC during the one-year period, was 10.86%, 5.04%, and 7.54%, respectively. Per the Fund's prospectus dated 10/31/12, the expense ratio for the Olstein All Cap Value Fund Class C was 2.32%. Performance and expense ratios for other share classes will vary due to differences in sales charge structure and class expenses. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than performance quoted. To obtain performance data current to the most recent month end please go to our website at www.olsteinfunds.com.

The S&P 500® Index is an unmanaged index created by Standard & Poor's Corporation that includes a representative sample of 500 leading companies in leading industries of the U.S. economy and is considered to represent the U.S. stock-market performance in general. The Russell 3000® Index is an unmanaged index that measures the performance of the 3,000 largest U.S. companies based on total market capitalization, and represents approximately 98% of the investable U.S. Equity market. Investors cannot actually make investments in either index.

Inside this Issue

FEATURES

Investor Insight: Robert Olstein

Olstein Capital's Robert Olstein and Eric Heyman explain where they look first for insight in financial statements, why they started an activist-focused fund, why they're happy that fundamental value investing isn't particularly in vogue, and why they believe Sealed Air, Harman International, Dr Pepper Snapple, Intel and Checkpoint Systems are mispriced.

Your strategy is driven by an "inferential analysis" of financial statements. Describe what that means.

Robert Olstein: I've just always believed that the numbers are the most important and unbiased indicator of a company's value. As we dig through the financial statements, we make adjustments to reported earnings in order to eliminate what we believe are management biases or unrealistic assumptions. That allows us to not only have more representative inputs for our valuation models, but we also find it can provide insight that may not be so obvious to the investing public about the viability of a company's strategy, the sustainability of its performance, and how management decisions might impact future cash flows.

At the center of all that is an emphasis on free cash flow. I still believe that over the long run there are real companies behind the stocks we own and cash flow is the air that those companies breathe. You can not value a company without a clear position on the evolution of its future cash flows. As a result, most of our time is spent on how, or if, a company generates sustainable free cash flow, the level of ongoing investment required to maintain and/or increase free cash flow, and how much of a company's free cash flow will be available to investors.

My approach is predicated on the idea that the best long-term investors are those who make the fewest errors, both in magnitude and number. I said this when we first spoke [*VII*, September 28, 2005] and it remains as true as ever: I have yet to hear a management team warn of an existing problem, that if not resolved would result in a dramatic drop in the share price. Given that that's exactly what I most care about, I better do a lot more than listen to management to form my opinions.

Describe where you look first in researching a company's financials.

RO: We begin by reconciling the difference between free cash flow and reported earnings under accrual accounting. The smaller the difference, the higher the quality of earnings. The bigger the difference, the more work we have to do to understand the makeup and sustainability of free cash flow.

We look at the footnote on taxes, which reconciles the differences between earnings reported to shareholders and earnings reported to the IRS under cash-basis accounting. The lesser the difference, the higher the quality of earnings.

We look at the balance sheet and calculate the ratio of total assets to shareholders' equity. After learning some hard lessons during the financial crisis, we instituted a rule that any ratio above 2.5 to 1 is an exception, which doesn't automatically mean we won't buy it, but each individual position size will be limited and we won't ever have more than 10% of the portfolio in such exceptions at one time. That's nothing more than a recognition that when you're wrong with a leveraged business model, the hit to the stock price can just be too fast and too damaging.

We always compare depreciation and amortization provisions to capital expenditures. This is particularly important today because a lot of expenditures pre-crisis on bad acquisitions and excessive expansions have caused a disconnect between what's reported as depreciation and amortization and what's really necessary to spend going forward.

We analyze receivables and inventories to determine changes in each relative to changes in sales. Inventories and receivables increasing faster than sales can be early warning signs of future slowdowns. Inventories building in the right places,

Accounting Alerts

In more than 40 years of financial-statement analysis, Olstein Capital's Bob Olstein has seen all manner of accounting "smokescreens" that can effectively disguise a company's problems or misrepresent its economic reality. Below is an investor checklist of the key warning signs he's found that may signal all is not – or will not be – as it seems:

- ☐ Sizable negative divergences between cash flow and net income
- ☐ Questionable accounting for transactions with affiliates or joint ventures
- ☐ Material differences in tax accounting and GAAP accounting, as measured by deferred taxes
- ☐ Reversal of past reserves to artificially inflate earnings
- ☐ Realizing non-recurring gains, and netting these gains to hide past mistakes
- ☐ Lowering discretionary expenditures to meet earnings targets
- ☐ Continual characterization of material expenses as non-recurring
- ☐ Unrealistic depreciation schedules
- ☐ Capitalizing expenses based on unjustified optimism
- ☐ Serial acquisitions under purchase accounting that overstate internal earnings growth
- ☐ Lower inventory turns or negative inventory divergences from the past
- ☐ Accounts receivable rising faster than sales
- ☐ Unrealistic pension assumptions
- ☐ Non-disclosure of material information needed to assess company value

like raw materials and work-in-process, can be signs of future strength.

This isn't a comprehensive list, but another important factor is to review the content and frequency of so-called non-recurring factors that have contributed to or reduced earnings. We want to know if what's deemed non-recurring really is non-recurring.

Give some examples of errors you expect to avoid based on your reading of the financials.

RO: Revenue growth at Amazon.com [AMZN] has been impressive in recent years, but it concerns me that much of that growth has been financed by increased payables, that margins are so low, and that at the end of the day very little free cash flow is actually being generated. It's not obvious to me how that changes. It could certainly be through higher pricing or reducing the amount of free shipping, but how less competitive does that then make them if they take those paths? Given that I base my valuations on discounted future cash flows, I can't get anywhere near the current stock price of more than $225 in my assessment of value.

I recently read an analyst report, before the latest spike in Amazon's shares, saying the stock was going to $240. The analyst was expecting free cash flow in 2015 of something like $2.40 per share. So even if you believe cash flow goes from near zero today to $2.40 in a few years, why would you pay 100x that number for the shares? I'm not saying the company can't convert brilliant sales growth into brilliant growth in free cash flow, but let's say I'm skeptical it can happen at the level required to justify investing in the stock today.

It's down sharply in the past few weeks, but I was scratching my head earlier this year at the big stock-price run in Sears [SHLD]. At the same time they're talking up the brands and real estate they're going to "monetize," we believe they're significantly neglecting capital expenditures – specifically spending on improving the stores – and therefore overstating earnings for the core retail operation. Eventually shareholders will be left holding the bag with this overvalued, troubled business.

I started talking about this a year ago, but I'm still not optimistic about the ability of cruise-ship operator Carnival [CCL] to generate free cash flow. Over a several-year period its capital spending, for both maintenance and new expansion, has been significantly above depreciation. Reported earnings looked great, but it was in our view a false prosperity. The market buying into reported growth like that makes a stock quite vulnerable if there are any bumps in the road – and Carnival has hit a few such bumps in the past year.

ON AMAZON.COM:

I'm skeptical growth in free cash flow can happen at the level required to justify investing in the stock today.

Sometimes, of course, the numbers tell a more positive story. One of our happiest examples in recent years has been Macy's [M], in which we still have a position. When we started buying the stock more heavily in 2009, the company was reporting $1 per share in earnings and the share price was around $12 or $13. But the depreciation and amortization that was weighing down those earnings was far higher than the realistic needs for capital spending going forward. We thought the difference was on the order of $1.50 to $1.80 per share. So even at the depths of the recession, you had a company generating normalized free cash flow that was more than $2.50 per share, on a $12 stock. As bad as the overall outlook was at the time, that was too cheap to pass up. [*Note*: Macy's shares currently trade at around $41.]

When we spoke two years ago [*VII*, May 28, 2010], you were marveling at how the highest-quality companies had gotten cheap enough for you to buy for the first time in years. Is that theme still in place?

RO: It's still in place, but many of the valuation gaps have closed. It's taken some time, but the market appears to have recognized that slower growth at companies like Microsoft, Cisco and Disney isn't the end of the world and that valuations had corrected too far to the downside.

One blue-chip we believe still has plenty of upside is Intel [INTC], our second-largest position. In my career Intel has supposedly been on its deathbed maybe five times, this last time because it wasn't an early mover in supplying chips to smartphones and other mobile devices. Companies like Arm Holdings [ARMH] were going to eat its lunch. Less than a year ago analysts were predicting that Intel's earnings would peak at $2 per share and fall below that going forward, but now even the bears think it will earn $2.50 to $2.60 this year. So the stock has come back somewhat, but at today's price [of $28.40], but it still trades at 11x this year's estimated earnings.

What that ignores, in our view, is the fact that the company is building a $6 billion plant in Oregon that is going to produce – starting this summer, with full production hitting in early 2013 – a line of 22-nanometer chips for the smartphone market. The company says these chips have four times the processing power of anything in the market today and use only 75% of the power. If you read their shareholder letters, they're confident about their prospects in smartphones, which in our experience is not a position they take lightly. In the latest earnings report inventories looked a bit high, but they were high in raw materials and work-in-process, further evidence that they're gearing up to make a big splash.

Assuming base capital spending of $9 billion – less than what they spent in 2011 but 50% above what they spent in the few years prior to that – we believe normal free cash flow is around $2.25 per share. For a company this profitable and poised to drop a bomb on a giant market opportunity, we believe that's worth at least a 17-18x multiple, giving us a target price of around $40. If we're wrong, the low expectations already built into the stock and the 3% dividend yield should limit the downside.

Given your preference for not speaking to management, we were surprised to see you start an activist-focused fund. What's behind that?

RO: One reason was that we wanted to have a vehicle for investing in smaller companies, which are more likely to listen to us when we make pointed suggestions on what they should be doing to improve shareholder value. That's really the only kind of communication we have with management.

We have several criteria we look for in our activist investments: significant discounts to private market value; strong franchises suffering from bad strategic decisions; non-core, underperforming or non-productive assets; overcapitalization; steady cash flow combined with low returns on invested capital; chronic earnings underperformance; and questionable merger and acquisition activity. Regarding our activist approach, I would emphasize that we focus on concrete operating improvements or strategic changes instead of tricky financial maneuvers.

Eric Heyman: We'll talk later about Harman [HAR], which is the largest holding in our Strategic Opportunities Fund, but Cheesecake Factory [CAKE] is an excellent example of the type of situation we've looked for. It met all our criteria for an undervalued stock – we started buying more aggressively in late-2008 at a 15-16% free cash flow yield on our normalized estimates – but we also identified specific areas for improvement. One was the opportunity to significantly increase margins by reducing portion sizes that were bigger than people really needed. Another was to stop expanding because the incremental returns on growth were inadequate and the saved cash would be better utilized if returned to shareholders. We certainly don't take all the credit, but management recognized the logic of both arguments, and the performance improved. Our average cost for the stock was just over $18 and we sold our last shares in July of last year at $33.50.

Your main fund owns 75-85 stocks. How did you arrive at that?

RO: Some people are comfortable with more concentration, but my conservatism on that front goes back to the early 1980s when I owned too much Johnson & Johnson when its Tylenol issue hit. I just don't want the totally unforeseen event – which will obviously happen from time to time – to have an outsized impact on performance. By limiting our top position sizes to usually no more than 2.5% and our typical position to 1.5%, an outsized impact won't happen.

In addition to the balance sheet guideline I mentioned earlier, we also try to mitigate risk by buying at prices that we believe have a very low probability within two years of falling by 20% or more if we get it wrong. We'll make a downside free cash flow estimate and attach a conservative multiple to that. Because they don't expect to be wrong, investors too often don't adequately consider what can happen if they are. We try hard not to make that mistake.

ON THE DOWNSIDE:

Because they don't expect to be wrong, investors too often don't adequately consider what can happen if they are.

Your investment in Sealed Air [SEE] has had a surprise or two. What's the rationale for the stock today?

RO: The company is probably best known as the inventor of bubble wrap, which is just one of many packaging products it sells worldwide to industrial and food manufacturers to help them protect their goods as they travel through the supply chain. We first started buying the stock back in August 2009, attracted by the relative consistency of the business and the upside as the world economy recovered and free cash flow moved toward a normalized level of $1.80 or so per share. The stock was then below $19 and we estimated intrinsic value at $28.

Everything was going nicely, the stock got to $25, and we had just started to take some profits when the company last June announced it was buying Diversey Holdings for $4.3 billion. While there's overlap in the customer base, the acquisition took Sealed Air into new product areas – cleaning and sanitation supplies – and the market hated the debt being taken on to make the purchase. In fairly short order the stock fell below our purchase price and bottomed at about $15.

While we were hardly pounding the table in favor of the deal, at the new share price we felt the negativity was overdone and took our position back up to a full one. The basic rationale to us is sound: there are cross-selling opportunities to similar customer bases, costs to take out, and the combined company is better positioned to take advantage of both emerging-market growth and increasing regulatory efforts to enhance food safety and hygiene. While dilutive this year, we expect benefits from the acquisition to be more obvious starting in 2013.

Is there a forensic-accounting aspect to this idea?

RO: If we adjust for excess depreciation and amortization from the takeover and from some past capital expenditures that were higher than they need to be going forward – adding 80 cents to consensus 2013 earnings estimates – we believe normalized cash flow is at least $2.50 per share. So while the stock already looks fairly cheap on earnings, at today's price [of $19.25] it also trades at a 13% normalized free cash flow multiple.

Put what we think is a reasonable 12x multiple on 2013 estimated free cash flow and we get a share value of $30.

Is the balance sheet a concern?

RO: It's more extended than we'd like, with the ratio of total assets to shareholders' equity at 3.8 to 1. That makes it an

INVESTMENT SNAPSHOT

Sealed Air
(NYSE: SEE)

Business: Provider of a wide variety of protective packaging, cleaning and sanitation products and systems to global food-service and other industrial customers.

Share Information
(@4/27/12):

Price	**19.24**
52-Week Range	15.05 – 27.55
Dividend Yield	2.7%
Market Cap	$3.70 billion

Financials (TTM):

Revenue	$5.64 billion
Operating Profit Margin	10.3%
Net Profit Margin	2.6%

Valuation Metrics
(@4/27/12):

	SEE	S&P 500
Trailing P/E	24.0	16.1
Forward P/E Est.	12.8	13.2

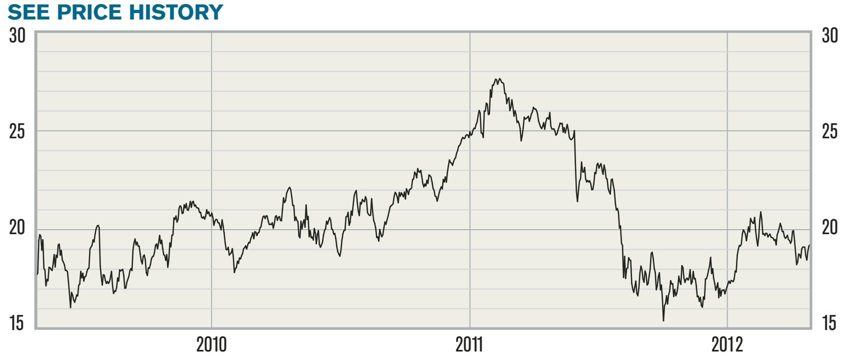
Largest Institutional Owners
(@12/31/11):

Company	% Owned
Vanguard Group	5.0%
State Street	3.8%
International Value Adv	3.8%
BlackRock	2.6%
Glenview Capital	2.4%

Short Interest (as of 4/13/12):

Shares Short/Float	1.5%

SEE PRICE HISTORY



THE BOTTOM LINE

While the market is angry about the company's acquisition last year of Diversey, Bob Olstein believes the combined businesses are well-positioned to take advantage of emerging-market growth and increasing regulatory efforts to enhance food safety and hygiene. At 12x his estimate of 2013 free cash flow, the shares would be worth $30.

Sources: Company reports, other publicly available information

"exception," which is why we have a 1.4% position rather than a 2.5% one.

We think this is a stable, recurring business that generates free cash flow in a good or bad economy. They aren't serial acquirers and management is focused on paying down debt. All in all, we don't believe the company will ultimately have any trouble servicing the debt.

There's an outstanding settlement involving asbestos liability from a past purchase of a W.R. Grace division. Is that a risk?

RO: The terms of the settlement have been defined and reserved for and while we can't be certain, we don't believe there will be a negative surprise with the final resolution. Once it's settled, Sealed Air will no longer need to expense about $40 million per year in settlement-related interest, which will provide a nice bump to reported earnings.

Describe the potential you continue to see in Harman International.

EH: Harman sells a wide range of audio and entertainment systems to automotive, consumer and professional markets, under brand names including Harman Kardon, Infinity and JBL. While its legacy is in high-end stereo systems for the home and in audio equipment used in concert halls and stadiums, around 70% of revenues today come from selling audio, electronic and infotainment systems to automobile original equipment manufacturers. This is what is becoming the car "command center," which includes or controls things like the audio system, GPS displays, voice-activated applications, rear-view cameras and smartphone connections. As an example, consoles like Harman's might access recent e-mails from your smartphone and then "read" them through the speakers. As consumers look to extend their electronic lives to the car, Harman wants to be in the middle of that.

We first got interested in the company a few years ago after it brought in a new CEO to expand an entrepreneurial operating style to one that also focused on cost control, free cash flow and a sound balance sheet. That effort has been largely successful and we now think the company is hitting its stride on all fronts – operationally, in product development and in the sales effort.

If cars are going to be the driver, are you counting on a positive global environment for new-car sales?

RO: Harman is positioned to benefit in multiple ways. One would be a continued rebound in overall new-car sales in developed markets. Another would be sales growth in emerging markets. Another would be in signing up big new customers, as it has recently with Volkswagen, Toyota and – a first in China – Changan Motors. Finally, it can expand its footprint within brands in which it's already present. Mercedes has used Harman systems for three years, but maybe they add a new application or two into it. Harman benefits from all that.

There is competition, but it tends to be smaller stand-alone companies or in some cases manufacturers themselves, like Ford. For the time being, the market is receptive to what Harman is offering. Total company backlog, much of which is auto-related, is now over $14 billion.

INVESTMENT SNAPSHOT

Harman International
(NYSE: HAR)

Business: Designs and manufactures high-end audio systems for consumer, professional, and automotive original-equipment manufacturer markets worldwide.

Share Information
(@4/27/12):

Price	**47.30**
52-Week Range	25.53 – 51.76
Dividend Yield	0.6%
Market Cap	$3.32 billion

Financials (TTM):

Revenue	$4.16 billion
Operating Profit Margin	5.9%
Net Profit Margin	3.9%

Valuation Metrics
(@4/27/12):

	HAR	S&P 500
Trailing P/E	20.9	16.1
Forward P/E Est.	16.4	13.2

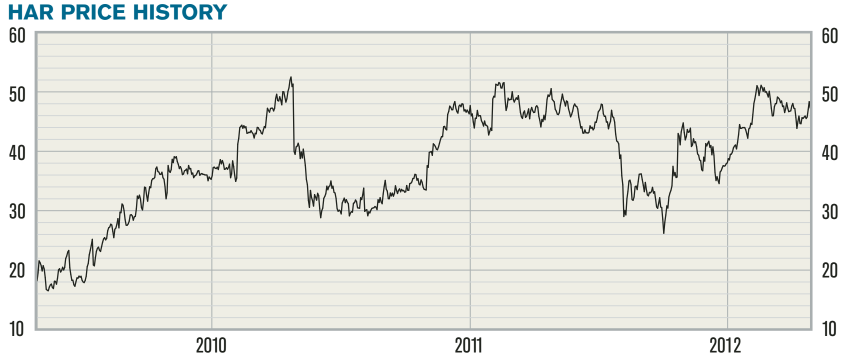
Largest Institutional Owners
(@12/31/11):

Company	% Owned
Capital World Inv	8.2%
T. Rowe Price	6.6%
Vanguard Group	5.4%
TCW Group	4.1%
Relational Investors	3.8%

Short Interest (as of 4/13/12):

Shares Short/Float	2.5%

HAR PRICE HISTORY



THE BOTTOM LINE

The company will benefit from its strong position in providing electronic infotainment systems to car makers as consumers increasingly desire to "extend their electronic lives to the car," says Eric Heyman. At 16-17x his estimate of 2013 free cash flow – adding back $5 per share in net cash – the shares would be worth around $75.

Sources: Company reports, other publicly available information

These auto-manufacturer relationships take time to get set up and running, but we're expecting to see the first signs of exciting growth coming through the financials by 2013.

With the shares today at $47.30, how are you looking at valuation?

EH: We think within the next couple of years the company can generate $5 billion in annual revenue. Assuming operating margins stay at today's level of 8%, that would translate into roughly $4.25 per share in free cash flow. If you take out $5 per share in net cash on the balance sheet, the free cash flow yield is 10%.

Given the growth prospects and profitability, we don't consider this just another car supplier and believe that if we're right on earnings, there's no reason the stock shouldn't have a 16-17x market multiple. On our 2013 cash flow estimate – adding back at least $5 per share in cash – that would give us a share value of around $75.

RO: We're not building this in, but we believe the company is capable of 10-11% margins. Then you're talking about north of $5 per share in free cash flow per share. That's the type of kicker we like to hold in reserve – there are always things that can go wrong as well.

What attracted your attention in Dr Pepper Snapple [DPS]?

RO: This isn't a story about international growth or exciting new products, but a case where we see an impressive stable of brands – including Dr Pepper, 7UP, Crush, Canada Dry, Snapple and Mott's – that can grow profitably from continued basic improvement in marketing and distribution. The company was spun out in 2008 from Cadbury, which had more or less been milking it for cash flow and not adequately investing in the brands. Within six or seven months of our first buying the stock in November 2009, Dr Pepper signed new distribution deals with both PepsiCo, for $900 million, and Coca-Cola, for $715 million. That was clear confirmation to us that there were valuable assets in the company that hadn't been fully utilized.

Are you counting on any market growth in the U.S.?

RO: The flavored-drink category in the U.S., in which Dr Pepper has several leading brands, is modestly growing, while carbonated colas are in slow decline. We see this much more as a market-share story. It's really just basic blocking and tackling. The Dr Pepper brand is now far more broadly distributed in McDonald's, for example. The company is investing in dispensers to increase coverage in higher-profit single-serve outlets. After losing their way, the Snapple and Mott's brands are showing signs of being turned around.

Why hasn't the company been more active outside the U.S.?

RO: Around 93% of last year's revenue came from the United States and Canada, with the rest coming mostly from Mexico and the Caribbean. The simple answer to why they haven't been more active internationally is that

INVESTMENT SNAPSHOT

Dr Pepper Snapple
(NYSE: DPS)

Business: Production, marketing and distribution of nonalcoholic beverages primarily in the U.S. Brands include Dr Pepper, 7UP, Hawaiian Punch, Mott's and Snapple.

Share Information
(@4/27/12):

Price	**39.72**
52-Week Range	34.37 – 43.13
Dividend Yield	3.4%
Market Cap	$8.42 billion

Financials (TTM):

Revenue	$5.90 billion
Operating Profit Margin	17.3%
Net Profit Margin	10.3%

Valuation Metrics
(@4/27/12):

	DPS	S&P 500
Trailing P/E	14.5	16.1
Forward P/E Est.	13.5	13.2

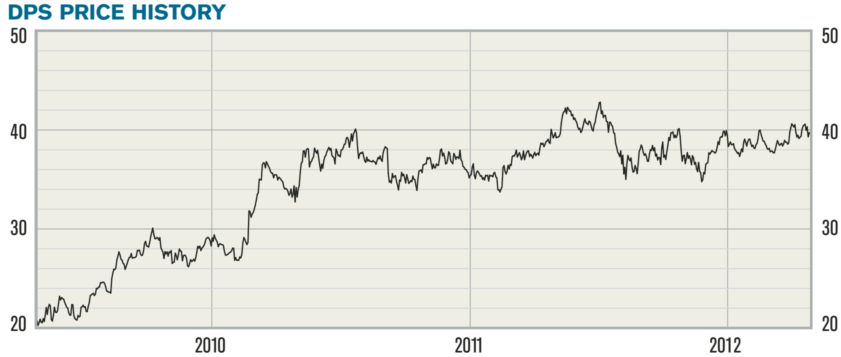
Largest Institutional Owners
(@12/31/11):

Company	% Owned
Morgan Stanley	7.4%
Fidelity Mgmt & Research	6.9%
Cedar Rock Capital	6.5%
Vanguard Group	6.1%
State Street	4.0%

Short Interest (as of 4/13/12):

Shares Short/Float	4.9%

DPS PRICE HISTORY



THE BOTTOM LINE

It's not generating excitement with new products or international growth, says Bob Olstein, but the company has more potential than the market expects to produce incremental returns through marketing and distribution "blocking and tackling." His estimated value for the shares, at 16x his 2014 free cash flow estimate, is $56.

Sources: Company reports, other publicly available information

they've had too much of import to do in North America. The more complicated answer is that their international trademark rights are a hodgepodge – they only own certain trademarks in certain countries. We would expect them to eventually get that sorted out in a positive way – which would open up attractive growth opportunities – but it's not something we're factoring into our current valuation.

Having tread water for much of the past two years, what upside do you see in the shares from today's $39.70?

RO: With 3% revenue growth and some operating leverage, we think this is at least a 5% annual bottom-line grower over the next few years. Within two years we're expecting free cash flow per share to be around $3.50. We believe that deserves at least a 16x multiple, which would get us to a share price of $56.

This is one of those ideas, like Intel has been for us so far, where you're likely to make your money a quarter or 50 cents at a time and two or three years later you're up maybe 50% on your position. It's like you almost don't notice it. We love ideas like that.

Checkpoint Systems' [CKP] shares have been a bust over the past year. What gives you confidence the company can turn that around?

EH: This is a classic case where we have to judge whether the performance issues facing the company are temporary or structural. Almost all companies endure varying degrees of problems and in trying to weed out value traps we focus on things like the viability of the core business, balance sheet strength, how clean the accounting is, and how well management is responding to the problems.

We'd followed Checkpoint for years, attracted to its leading market share in a fragmented market for security and shrink-management systems for retailers. Its key products include closed-circuit televisions and electronic article-surveillance systems that deter theft through tags attached to merchandise that are disarmed at the checkout. As the stock traded lower and lower on disappointing earnings, and as we saw a clear change in management's tone about where it needed to focus its attention, we recently bought in.

One obvious problem over the past few years has been a less-than-robust retail environment, as consumers tightened up on spending. The company benefits when retailers are expanding and investing in new technology. The environment hasn't been great for that, but we're seeing the better retailers showing more confidence in their businesses and spending more on security and shrink control, which should eventually increase Checkpoint's order flows. We're not building in aggressive top-line growth, but we expect it to be at the level of GDP plus a point or two.

The biggest problem has been in how the company has been run. When the recession hit, rather than stick with growth and business-development plans that no longer made sense, management should have put much more emphasis on operating efficiency and margin improvement. Over the past two quarters we've seen a significant change in what the company is saying in that regard. They've

INVESTMENT SNAPSHOT

Checkpoint Systems
(NYSE: CKP)

Business: Global manufacturer and marketer of tracking, security and merchandising products and systems, primarily for apparel and retail customers.

Share Information
(@4/27/12):

Price	**11.19**
52-Week Range	10.35 – 21.27
Dividend Yield	0.0%
Market Cap	$451.0 million

Financials (TTM):

Revenue	$865.3 million
Operating Profit Margin	4.5%
Net Profit Margin	(-7.7%)

Valuation Metrics
(@4/27/12):

	CKP	Russell 2000
Trailing P/E	n/a	40.5
Forward P/E Est.	16.2	19.7

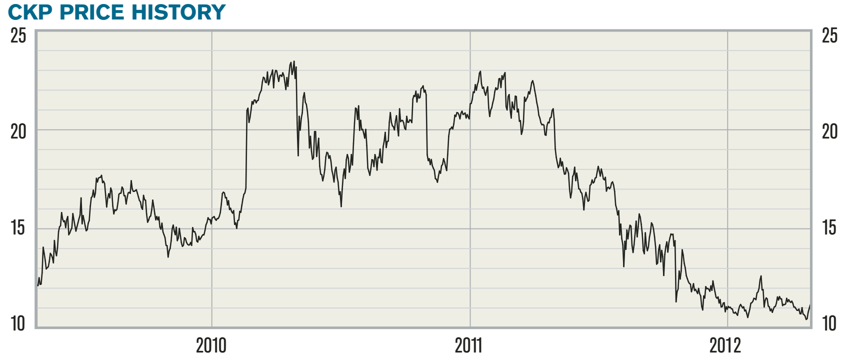
Largest Institutional Owners
(@12/31/11):

Company	% Owned
Shapiro Capital Mgmt	11.1%
Earnest Partners	9.9%
Tocqueville Asset Mgmt	8.9%
Vanguard Group	5.2%
Invesco	5.0%

Short Interest (as of 4/13/12):

Shares Short/Float	4.3%

CKP PRICE HISTORY



THE BOTTOM LINE

Having been slow to respond as the retail environment affecting its customers weakened, the company appears finally to be righting its operational ship as the retail environment is improving, says Eric Heyman. If the company can double its operating margins in the next couple of years, he sees at least 50% upside in the share price.

Sources: Company reports, other publicly available information

announced plans to overhaul the business, reducing headcount, consolidating facilities and discontinuing unprofitable product lines. We think there's a lot of low-hanging fruit here, and that operating margins should be twice the 3-4% they've been doing.

If you're right, how do you see that translating into upside from today's $11.20 share price?

EH: With $850 to $900 million in revenue and a 7-8% operating margin (including excess depreciation), the company should earn up to $1.10 per share in free cash flow. With a 15-16x multiple, you're at $16-17 per share.

The biggest risk in our view is management execution. The competitive position of the company's products is strong, as is the balance sheet. More than half the battle is a full recognition that something needs to be done on the operational side, which we believe is there.

You've had success in the past investing in money managers. Why did you give up on AllianceBernstein [AB] late last year?

RO: We started buying at the tail end of the 2008-2009 crisis, paying far too much in the beginning, in the mid- to high-$20s, and buying our way down to $12. This was a first-class, value-based money manager with a great brand name, that because of the market drop and a stretch of poor performance had seen its assets under management fall from around $800 billion to $450 billion. Our basic thesis was that there was tremendous operating leverage as the asset base naturally recovered, and that at $550 billion or so in assets the normalized earnings power was $2.50 per share. That was interesting with the stock at $25, and extremely interesting when it was at $12.

Assets continued to walk out the door and we concluded that the traditional value-investing philosophy that had made the Bernstein name – and which was important to us as investors – was being actively diluted by new management. Key value managers were leaving and the company was diversifying into hedge funds and other alternative investments. Could that work out? Sure, but that wasn't the investment we wanted to make. When a fundamental tenant of our thesis changes, we'll typically exit first and ask questions later. We started selling at $17 and were out as low as $14 last September. [*Note*: AB shares currently trade at $14.15.]

With things like robo-trading, ETFs and risk-on/risk-off strategies so prevalent, does the market today ever make you feel like a bit of a dinosaur?

RO: I've never seen a period that was so influenced by short-term thinking, but even though it may not always feel like it, I think things are set up nicely for fundamental value investors today. We should be more worried about our style of investing coming into vogue, because then we won't be able to find the discounts to intrinsic value we want.

The person with the highest probability of outperforming over time is the one who knows how to value companies and buys at a significant discount from that. I've heard for 45 years why all these other things have become more important. You know what? It's all crap. VII

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