

Value managers go on a shopping spree

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Illustrations: Color Photo: Peter Redman, National Post File Photo / Gavin Ivory of Beutel Goodman & Co. says his team has added almost as many new names to their global portfolios in the first quarter of 2008 as they did in all of 2007.

The poor performance of the world equity market since the start of this year has left a number of leading brand-name stocks such as Nokia and McGraw-Hill trading at compelling valuations, says Gavin Ivory, vice-president, global equities at Toronto-based Beutel, Goodman&Co.

"Indeed we have added almost as many new names to the global portfolios in the first quarter of 2008 as we did in the whole of 2007," says Ivory, who heads value manager Beutel, Goodman's global equity team.

"The first quarter saw investors selling the higher-quality, liquid stocks that they could, rather than the poor ones that they should have," he says.

Colleague Ehren Mendum notes that as a result of this strategy "quality stocks were trading at a discount."

The global equity team consists of four players--Ivory, Mendum, Glenn Fortin and KC Parker. This quartet is responsible for assets of almost \$1-billion. In all, Beutel, Goodman has \$16-billion under management.

The firm uses a strict value discipline in managing all of its equity portfolios. An important consideration in investing in a stock is a company's ability to generate free cash flow and then demonstrate a strong discipline in spending that cash flow.

To qualify for inclusion in a portfolio, the stock must be capable of producing a total return of 50% during the next three years, Ivory says.

The sell discipline is equally rigorous. Managers will sell one-third of the holding in a stock when it reaches the target price set for it. The stock is then re-evaluated and if it the target price is not raised, the rest of the holding is sold.

The global team has not added any new financial services names this past quarter and is generally holding off adding to their weighting in this sector. "We are willing to give up some of the initial upside to ensure that the worst of the credit crisis is over," Ivory says.

But in technology, the team has established a position in Finnish handset maker Nokia Corp.

With a market capitalization of US\$130-billion, Nokia is the largest mobile handset manufacturer in the world.

Nokia continues to broaden its product line and expand into new markets, Mendum says. "This helps it to maintain its global market share."

Nokia's U.S. rival, Motorola, has had a product stumble, says Mendum, and this could help Nokia increase its fairly modest market share in the United States. Nokia is also making good headway in emerging markets.

On its financials, Nokia has no debt on its balance sheet and cash of US\$17-billion, "which is a considerable war chest."

The stock trades at roughly 13.3 times 2008 consensus EPS estimates and 12 times the consensus for 2009. This valuation, says Ivory, is at the low end of Nokia's historic P/E range. The stock has a dividend yield of 2.3%.

"It is the first time that this stock has met the team's criteria," Ivory says.

"Nokia's return on capital has been rising sharply for a number of years, yet the stock's valuation has been declining over that period," Mendum says.

Another new name added to the portfolio is New York-based publishing company, McGraw-Hill Cos. Inc., which has a market capitalization of US\$12-billion. McGraw-Hill's products and services include educational books, business media and Standard & Poor's operations. The latter provides financial information, ratings and analysis to the financial markets.

"The global credit crisis hit rating agencies hard and McGraw-Hill's stock suffered; S&P accounts for two-thirds of its profits," Mendum notes.

But he expects S&P's rating business, though out of favour now, to revive in 2009.

Mendum's EPS estimate for 2008 is US\$2.87 and US\$3.19 for 2009. This puts the P/E multiple on the stock at 13.6 times 2008 and 12.2 times 2009. The stock has a dividend yield of 2.3%. The company, says Mendum, has "consistently bought back stock and raised its dividend." Two other new names:

- Covidien Ltd. of Hamilton, Bermuda, a global health-care company spun out of Tyco International, produces a diverse range of products "from surgical stapling to sutures," Ivory says.

"The company is largely immune to cuts in public health care spending; its products are critical to the health-care industry and not that price sensitive."

Covidien is investing substantially in R&D and sales infrastructure. It is seeking to better its existing product offering and add new products. The company is also expanding its geographic reach, he says. It currently operates in 130 countries and is making headway in emerging markets.

"Covidien is a stable, free cash flow generator," he says.

The stock trades at 17 times 2008 EPS estimates and has a dividend yield of 1.4%.

- WPP PLC. Based in London, Eng., this global advertising, marketing and communications group has seen its stock decline on concerning about the slowing world economy, says Mendum, but there are a number of factors that should boost revenues -- the Olympics, the U.S. election and the Euro 2008 soccer championship.

This stock, he says, trades at 11.8 times 2008 EPS estimates and 10.8 times 2009 estimates.

Beutel, Goodman's global equity team have sold their holding in a U.S. mid-sized oil and gas company, Devon Energy Corp. on the assessment that the stock had reached "full valuation," Ivory says. "The stock was being priced as if the company was an acquisition target."

The team also sold its holding in Shimano Inc. of Japan, one of the largest bicycle components manufacturers in the world. It also makes sports fishing equipment. "The stock was overvalued, it was priced for perfection," Ivory says.

SPOTLIGHT

NOKIA CORP.

Ticker NOK/NYSE

Close US\$33.69, up \$1.59

52-week range \$42.22-\$23.61

MCGRAW-HILL COS. INC.

Ticker MHP/NYSE

Close US\$38.05, up \$1.15

52-week range\$72.50-\$33.91

COVIDIEN LTD.

Ticker COV/NYSE

Close US\$45.40, up 85¢

52-week range \$49.70-\$36.90

WPP PLC

Ticker WPP/LONDON

Close 616p, up 21.5p

52-week range 785p-534p

DEVON ENERGY CORP.

Ticker DVN/NYSE

Close US\$116.63, up \$3.16

52-week range \$116.81-\$69.01

SHIMANO INC.

Ticker 7309/TOKYO

Close 5050¥, up 70¥

52-week range 5130¥-3440¥

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