

On-the-ground research is critical to understanding global industry dynamics



Phillip Cook

Phillip Cook and Elliot Cunningham recently traveled to Hanover, Germany to attend the bi-annual Agritechnica trade show, the world's largest exhibition of agricultural machinery and equipment. With over 2300 exhibitors from 46 countries and 350,000 visitors, this year's attendance hit a new record, with a meaningful increase of international visitors to over 77,000 attendees, 3,600 of which traveled from North America. The largest presenters at the show included: John Deere, AGCO, CNH Global, Claas, JCB, and Krone, as well as other significant players in the European agriculture market. The majority of attendees were full-time and part-time business farmers from around Europe.

In the interview below, Phillip discusses the team's findings from the trade show, particularly in regard to several of the portfolio's agriculturally-oriented holdings such as AGCO Corporation. The two also had the opportunity to do some additional due diligence on other portfolio holdings including Columbia Sportswear and Polaris Industries, also discussed below.



Elliot Cunningham

In addition to the South African Coal Conference in Cape Town, the SBB Steel Markets Conference in Chicago, and the World Nuclear Fuel Market Conference in Edinburgh, Agritechnica was the tenth industry trade show or conference SouthernSun Research attended in 2009. What are you are looking to glean from these venues, as you're often one of the only fund managers at these shows?

We continually look for opportunities to educate ourselves on the industries in which our portfolio companies participate, and these venues provide a great setting to learn from the people actually making and using these products and technologies. Simply put, we find it very difficult to learn about products and sales strategies by only reading an SEC filing or listening to a quarterly conference call, so we push ourselves to get out there and see companies in their own environments. We have found that when salespeople or operators are talking to customers or peers, you get quite a different perspective on the industry, competition, suppliers, and their views on the actions of senior management. These perspectives are invaluable in understanding the competitive landscape of an industry -- not to mention the fact that you occasionally learn about an interesting company that could be a new idea for our portfolio.

Trade shows like Agritechnica also provide a platform to see competing products and technologies from multiple companies side-by-side, which allows visual learners like us to better understand the competitive advantages (or disadvantages) of our companies. In addition, these trade shows are really the only place we have

the chance to see privately-owned competitors, suppliers, and customers. For example, AGCO has been rumored in the past to be interested in acquiring a number of private companies in Europe, and at a show like Agritechnica, we can meet with these potential targets to see if these products really make sense as additions to the AGCO product portfolio.

SouthernSun has long discussed the relationship between population growth, food supply, and the resulting need for technological innovation within the agriculture industry. You own several names as a play on this theme including Smithfield Foods, Darling International, and AGCO Corporation. Did you uncover anything new at the Agritechnica Conference to further support your current portfolio exposure?

Yes, for some time, we have firmly believed that the combination of population growth, the growing middle class in developing economies, and the increasing use of food for fuel create an unavoidable showdown for governments and agriculture. We have said for quite some time that we believe the fuels portion of this equation will look more like a buffet

than a single dish, so there will likely be multiple winners coming out of this new demand source. However, we also recognize that there will be many losers and only those companies with dominant products, technologies, and market share in each niche will successfully navigate through the ups and downs over the years to come.

We continue to maintain exposure to this "agriculture" theme within our portfolios, but are



Elliot Cunningham showcases AGCO's high-end Fendt combine at Agritechnica in Germany. The SouthernSun Research team attended ten such conferences in 2009 alone, believing on-the-ground industry and trade show research is critical to understanding the industry dynamics in which their portfolio companies' operate. These venues can also be a source of new investment ideas for the team.

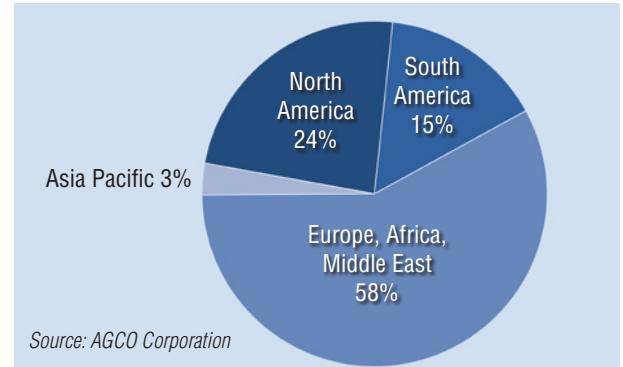
selective about our areas of exposure. We believe Smithfield Foods, the world's largest pork processor and hog producer, stands to gain from the growing global demand for protein, particularly from increasing exports to China, Mexico, and Russia. Similarly, we believe Darling International, the market leader in rendering and recycling inedible meat by-products, should also benefit from the growing international demand for protein as their end products are key inputs in animal feed. Furthermore, Darling's oil and grease products can also be used to manufacture biofuels, which continue to gain popularity as a viable alternative to petroleum fuel. Finally, AGCO Corporation has several world-leading tractor brands that should allow farmers to drive higher yields to meet the food demand of a growing global population.

As far as Agritechnica is concerned, I believe several nuggets of information came to light as we evaluate our exposure to agriculture now and into the future. First, in our opinion, Europe recognizes the necessity to be an exporter of technology in order to compete globally, and the Fendt brand of AGCO is the clear leader in Europe from a tractor technology standpoint, commanding a premium price, even to John Deere. Second, most every major player in Ag recognizes the importance of Central and Eastern Europe and Russia to the long-term solution to food supply. We believe AGCO has made substantial investments in relationships, production, and distribution in these markets and has a clear advantage with their already market-leading position in Western Europe.

Knowing that AGCO has approximately 75% of its revenues coming from Europe and Latin America, how has this U.S.-based firm managed to be so successful in non-US markets? Can we expect similar success for the firm in the U.S.?

For starters, even though AGCO is headquartered in Duluth, Georgia, AGCO's Chairman and CEO is German and quite familiar with business in Western Europe. In addition, I believe he is more internationally minded than most American business managers and has led the company to make significant and steady investments in markets like Brazil, Argentina, Russia, and most recently, China.

In addition, one thing we've learned by going to Ag trade shows around the world is that a company can only be successful by understanding what farmers want within that particular region and what engineering products are available to meet those needs. For example, our conversations with European farmers often revolve around high technology and their desire to use cutting edge equipment on their farms. European farmers also seem to care much more about fuel efficiency and the inside of the cab, perhaps because there are simply more farms, most of which are smaller, in Europe than the U.S. These regional differences should drive the



Source: AGCO Corporation

Over 80% of AGCO's sales are outside the U.S., making SouthernSun research visits to non-US plants and facilities essential. Phillip and Elliot also had the opportunity to meet with AGCO's CEO, Director of EAME, and executives for both Fendt and Massey Ferguson brands following the conference.

engineering and marketing strategy of farm equipment manufacturers, a concept AGCO has embraced to the nth degree.

In my opinion, AGCO has been very smart to tailor its brand and product lines to meet the different needs of farmers around the world. For example, AGCO markets and sells the more moderately priced Valtra and Massey Ferguson in South America, in part because there is no demand for AGCO's high technology Fendt tractor, which is quite popular with farmers in Europe. And, AGCO does not want the Fendt name to be associated with anything but premium technology.

Additionally, part of the reason why we like AGCO so much is that the business has been able to consistently generate discretionary cash flow and has a track record of creating long-term value instead of making short-term decisions. As for the U.S. business specifically, we see significant margin improvement ahead, where they for years have had less than optimal distribution and too many dealers. In fact, we have already seen some of the benefits showing up in this year's numbers despite the low volumes.

You had breakfast with the CEO and Chairman of AGCO, and also had a chance to sit down separately with the Head of Operations and Head of European Marketing. Can you share some insights from those conversations?

Well, as you know, meeting and speaking with all levels of management in key regions is core to our investment process, and I firmly believe what Michael Cook has always taught me: "you can learn as much, if not more, in the break room as you can in the board room." Our time with Martin Richenhagen, the CEO, was very valuable from a big picture, global perspective. Then we met with Gary Collar, the head of Europe, Africa, and the Middle East (EAME), to get more granular on those specific regions and the strategy there going



Phillip Cook test drives a Fendt tractor in Germany. The Fendt brand, manufactured by AGCO Corporation, is the clear leader in Europe from a tractor technology standpoint, commanding a premium price, even to John Deere.

forward. Finally, and just as important to us, we met with multiple members of Fendt’s management team and Massey Ferguson’s management team to better understand the current operating environment for each brand and each country in Europe, while gaining a better understanding of the real benefit that several hundred million dollars in capex spending should create for them.

For example, while meeting with Fendt’s management at their facility in Germany, we witnessed how new technologies and the implementation of manufacturing efficiencies have improved their transmission manufacturing line; originally built to produce 10,000 units a year, this same line can now manufacture 17,000 units per year. At the Massey plant in France, we were given the opportunity to try out their new virtual design and testing equipment which allows engineers to increase the iterations of new product design, while cutting costs dramatically by eliminating the need to manufacture a new prototype for each and every design.

As many of you also know, I lived in Europe for the first year I worked with SouthernSun, gaining a better appreciation for the business, personal cultures, and traditions that must be put into context in order to properly evaluate decisions made by U.S. companies in that region. In addition, I’ve found being able to speak their language and appreciate the uniqueness of each country really does facilitate more meaningful dialogue with people who are much more social in a business setting, in many respects, than Americans. I believe this recognition and study has provided our research team with a unique angle with which to analyze our businesses and uncover value for our clients.

Did you have a chance to research any of your other portfolio companies while you were over in Germany?

Obviously, the purpose of this particular trip was to attend Agritechnica and sit down with AGCO management. However, we were able to do a bit of helpful research on Polaris Industries (PII) and Columbia Sportswear (COLM) during our time there. Polaris has listed international business as one of its top growth drivers for the long-term and has steadily grown this portion of the business over the last decade. As a part of this strategy, the company has used a combination of distributors and direct sales presence to grow its business in Europe. We were able to talk with and view products from the Polaris distributor in Germany at Agritechnica and learned some interesting information about the headwinds the company may face. First, European customers tend to view ATVs as toys with no functional link to real life, so distributors focused their booths at the show on farm implements that can be used with both ATVs and side-by-sides. This way, farmers can see the multi-functional nature of these machines, which are cheaper, more useful, and more durable than trucks or tractors. We also learned that European distribution has been difficult for Polaris because there just aren’t many dealers in a country as big as Germany, and people want to be close to a dealer when they are spending large sums of money on a machine. We’ll definitely keep both of these issues in mind as we further evaluate and monitor Polaris’ European revenue potential.

With 20% of sales in EAME, Columbia Sportswear is definitely focused on its growth potential in this large outdoor apparel market. However, Columbia has struggled to get a foothold in the German marketplace, so Elliot and I visited multiple specialty outdoor stores and department stores to gage Columbia’s presence, products offered, signage, positioning, pricing, and level of discounts. We also wanted



Polaris Industries, a core SouthernSun holding, has listed its non-US business as a top growth driver over the long-term. While at Agritechnica, Phillip and Elliot visited with the German distributor for Polaris to better understand the firm’s strategy for capitalizing on growth opportunities in Europe.

to evaluate these same details for Columbia's competitors, of course. We therefore spent time in a Jack Wolfskin retail store learning more about the product offering and price points for this European leader in outerwear. The experience proved to be time well-served from a learning perspective, as well as providing fodder for our future discussions with COLM's European management team.

Greater than 50% of your portfolio companies have significant exposure to non-US countries, just like AGCO. And, as we all know, your investment team is known for its extensive and thorough on-the-ground research, spanning all management levels and geographical locations for your holdings. How did this approach lead to Michael Cook's creation of the Director of Research position?

Well, several years ago, we didn't exactly need a Director of Research because there was no one to direct. Michael did everything himself, which definitely led to bandwidth problems given our extreme commitment to on-the-ground research. Given the build out of our investment team, combined with the amount of time we spend at plants and facilities, we found that we really needed one person on the team to dedicate part of his time to tracking visits, making sure we're consistently and systematically covering all elements of our portfolio companies, looking for new ideas, and furthering our general industry knowledge. This was really the genesis of creating the Director of Research position, as well as deciding to divide regional coverage responsibilities across our analysts.

I believe this approach has allowed our team to improve the depth and breadth of our analysis for both current portfolio holdings, as well as new ideas. In addition, our younger analysts are able to get out from behind a computer screen, learn from people in the trenches, and see firsthand how companies operate, reinvest cash flow, and make strategic decisions. Because we're all generalists within the portfolio, this approach allows us to have a more complete, global picture of our holdings and the geopolitical and competitive landscapes in which they operate.

For example, one of our holdings, Arch Chemicals, is a global biocides company providing innovative, chemistry-based solutions to control the growth of harmful microbes. Even though the firm is US-based, approximately 53% of the firm's revenues are generated in South America, Europe, Africa, and Asia. We therefore have spent time meeting with and visiting facilities both within the US and outside, which has not only given us a better understanding of the customers and competition globally, but also the people making decisions and running plants in each region.

When Arch recently announced the unexpected departure of its COO and realignment of senior leadership, our "sector generalist, regional specialist" coverage approach became invaluable. At least one member of our research team had already met with each of the newly appointed Senior Vice Presidents in past visits to global facilities and offices. For instance, Mike Cook (no relation to our CIO) was appointed the new Senior VP of HTH Water Products, after the reorganization. Given I cover Europe, along with Elliot, we had already spent time with him on our last trip to Italy, when he was responsible for Arch's European coatings business. We'd also met Graham Buchan during that trip, who has subsequently taken over Mike's role in Italy. Similarly, Michael Cook, who covers Asia for our research team, had already visited Arch's Suzhou, China, operations and met with Rick Walden by the time Arch announced the COO's resignation; subsequently, Rick became the new Head of Industrial Biocides, Performance Products, and Asia Pacific for Arch.

Given the extent of our pre-existing relationships and knowledge base, we were able to quickly aggregate our findings and evaluate the potential of these individuals within their new roles. In the end, our "sector generalist, regional specialist" approach allowed us to make a critical investment decision, with confidence, in a relatively short amount of time.

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