

What Helps Us Sleep At Night – Part 3

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Some of our investment partners have expressed an interest in receiving an update on “What is helping us sleep at night – part 3”. Specifically, they want to understand how we could possibly get any shuteye these days given the extreme amount of negative news in the media. The bottom line is we don’t get too fussed by the noise in the media. Instead we focus on the performance of the businesses that make up our portfolios. The reality is nobody knows if the markets will experience a pull back, how sharp it could be, or how long it might last, although the media would like you to believe otherwise. We don’t waste our time trying to forecast such things. Rather, we consider the facts surrounding the underlying businesses we own. Below are some quick thoughts about three businesses that represent approximately 15% of EdgePoint Global Portfolio. These are the things that we think about as we drift off at the end of the day.

The Progressive Corp. (PGR)

Fourth largest auto insurer in the U.S.

- Policies in force are growing 4x faster than the economy. Policy growth of 8% year-over-year, driven by a 15% growth in their direct business (as at 7/31/2010). Most of the industry is seeing no growth or are shrinking.
- Profitable. Expected return on equity (ROE) for 2011 is between 15% and 20%. Annualizing PGR’s year-to-date performance equates to an ROE of roughly 19% for 2010.
- PGR’s business grew in 2008, 2009, and will grow again in 2010 – during the largest economic shock in a long time
- 11x earnings per share (EPS)
- Generating too much cash to put back into the business so is using the cash to buy back shares

Progressive was included in the original “What helps us sleep at night” (02/2009) as well as the second one (12/2009). The share price has appreciated approximately 80% since the first and 24% since the second writing.

WellPoint Inc. (WLP)

Leading health-benefits company in the U.S. (think HMO)

- One in nine Americans receive health coverage for their medical care through WLP
- In the face of the worst unemployment situation in the U.S. in decades, WLP grew their cash flows per share in 2009 by 7% and are on track to grow them in 2010 by 23%
- Generating too much cash to put back into business so is using the cash to buy back shares. WLP will have bought back over 10% of its shares by the end of this year.
- In an interview conducted on Sept. 13th, 2010 with the CFO, he said the following:
 - “We have the lowest costs in the country right now.” – This matters if you want to earn a good return.
 - “We have the largest discounts” – This matters to consumers of health care, especially during tough economic times.
 - “We’ve seen more larger employer groups go out for bid. And we’ve been quite successful in winning a number of those.”

- “The issue you have over the next several years are the number of mandates and the ability to get ready for health reform and all the good aspects of it are going to require scale. And the more scale we can get, the more we can spread those costs over a broader base. WLP believes we have a lot of opportunities regardless of consolidation” – WLP is not standing still just because they have the lowest costs today. They are looking to widen their lead.
- WLP has a free cash flow yield of 12% and is trading for less than 10x EPS

WLP was included in the original “What helps us sleep and night” (02/2009) as well as the second one (12/2009). The share price has appreciated approximately 63% since the first and 1% since the second writing.

Gerresheimer (GXI)

Specialty glass and plastic producer for the pharma and life science industries

- GXI is the only healthcare supplier to offer a broad range of anti-diabetes products (think insulin injection pens):
 - Diabetes is growing at a 14% annual rate globally
 - Number of diabetics globally in 15 years is estimated to be 350 million
- Tubular glass syringes are so difficult to make that only two companies in the world manufacture them (think syringes used to administer protein-based drugs)
 - GXI is one of these two companies
 - 5 years ago, GXI had a 0% market share in tubular glass syringes. Today they have a 15% share.
 - They believe they can grow to 50% of this market, which would increase their total company revenue by 30%
- Emerging markets represent only 10% of GXI’s business today but are growing at 16% annually
- GXI is bigger today than when the financial crisis started
- GXI is more profitable today than when the financial crisis started
- GXI has the potential to double its EPS in next five years

Gerresheimer is a recent addition to the global portfolios, and therefore, was not included in either the first or second “What helps us sleep at night” write-ups.

The bottom line is that we don’t lose sleep because of what the media is saying. Our sole focus is on the underlying fundamentals of the businesses that we own. PGR, WLP, and GXI’s fundamentals are strong (even in this tough economy), and this helps us sleep at night.

Tye Bousada

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