Profiles in Investing *by Eli Rabinowich*

Value Investing in Practice: Leon Cooperman

*Welcome to "Profiles in Investing", brought to you by The Bottom Line and **The Heilbrunn Center for Graham & Dodd Investing**. Every week we will profile a leading investor and get an inside look into his or her investment philosophy*

Vital Statistics

- Chairman, Omega Advisors
- Senior Member and past President of the New York Society of Security Analysts
- Member of the Board of Directors of Automatic Data Processing
- Trustee of Saint Barnabas Hospital
- Chairman of the Saint Barnabas Development Foundation
- Member of the Board of Overseers at Columbia Business School
- Member of the Board of Directors of the Cancer Research Fund of the Damon Runyon-Walter Winchell Foundation
- Member of the Investment Committee of the Museum of Modern Art
- Voted number one portfolio strategist in Institutional Investor nine years in a row
- Retired as Chief Executive Office of Goldman Sachs Asset Management after 25 years of service
- MBA, Columbia Business School '67
- BA, Hunter College

ER: You started your career on the sell-side - what do you think of the sell-side now?
LC: It doesn't make sense. They have outlawed analysts from taking positions in securities they cover. How can you take away someone's franchise? An analyst spends a lifetime building up expertise in a sector and then he can't even profit from it. You are left with a situation where all the good stock pickers will have to go to the buy-side and only the information providers will remain.

ER: What was your first great investment?
LC: I think it was my discovery of Teleydne and its extraordinary CEO Henry E. Singleton. In my opinion Dr. Singleton was one of the greatest managers in the annals of modern business history. No less an authority than Warren Buffet called Dr. Singleton "the best operating manager and capital deployer in American business."

ER: Tell us a little about him.
LC: Dr. Singleton formed Teleydne in the 1959 and throughout the sixties he used the company's sky high share price to make acquisitions. About 130 in all. The result of all this activity was that during the 1960's sales and net income climbed from essentially zero to $1.3 billion and $58 million, respectively. Now many managers have done that but what really set him apart was how he reacted when the cycle turned and his stock price declined. Dr. Singleton started buying up his company's own shares and from 1972 to 1984 he tendered eight times and reduced his share count by some 90%. His ability to buy his stock cheaply and correctly and time the short and long-term troughs is truly extraordinary.

ER: What made him such an extraordinary operator?
LC: In 1982, *Business Week* ran a critical cover story on Dr. Singleton. It accused him of "lacking a game plan" and of diverting funds from the company's operating business to allow the chairman to "play" in the stock market. In essence the article portrays the company's success as a direct result of the acquisition binge and massive share buyback. However the reality is more nuanced. Simply put, Dr. Singleton followed one guiding principal: he allocated capital where it could achieve the highest potential return for a given investment risk. He freely moved between financial assets and real assets. In a letter I wrote to *Business Week* after the article ran, I outlined five strategies Dr. Singleton followed to foster his company's development.

ER: What were they?
LC: One, he grew through acquisition when the company enjoyed an unusually low cost of capital through its high share price. Two, he managed his business extremely well. Without any acquisitions he grew net income from approximately $60MM in 1970 to over $400MM in 1981. And his return on equity ranged from 25% to 30% during this period. Three, he repurchased his security when it was cheap. By judiciously buying back stock in the seventies, earnings per share grew twice as fast as net income. Four, he recognized the long-term attractiveness of stocks over bonds. As the head of an insurance company, he had a responsibility to prudently invest his firm's capital and while his competitors were buying bonds, Dr. Singleton bought common stocks. And finally five, he built cash for uncertain times. He consistently positioned his company well and had the appropriate liquidity when he needed it.

ER: What stocks do you like right now?
LC: We like Healthsouth (HLSH). It's currently trading at about $4.75 and we think it's worth $8 to $10. Healthsouth is the largest provider of physical therapy and rehabilitative services in the world. Throughout the 90's HLSH used acquisition to fuel its rapid growth. Between 1990 and 1997 the market rewarded the company with an average annual growth in share price of nearly 40%. However, since then Healthsouth lost much of its value due to pricing pressure, reimbursement changes in home healthcare and suspicion of fraud and insider trading. In March 2003 these rumors were confirmed and CEO Richard Scrushy was charged with improper accounting and corporate excess. The stock traded down from $3.80 to a low of $.08. Immediately following these events Healthsouth removed its old management and hired turnaround specialists Alvarez and Marsal. Since March 2003, Alvarez has removed half of the corporate officers, restructured all current debt obligations, stabilized operations and sold non-core assets. Based on company guidance, industry analysis and very conservative estimates, we project earnings EBITDA of $750 million. Applying an 8 to 10 multiple on EBITDA we come up with a target share price approaching $10 a share.

ER: Given that much of the company's past financials have been fraudulent what is the basis for your projections?
LC: Not all of the company's numbers are wrong. Also Alvarez and Marsal has provided summary 2004 projections and we compared these numbers to industry averages. We took very conservative estimates of the company's performance. For example we assumed the company will only grow 3 to 5% next year despite the fact that healthcare expenses are growing at 9 to11% and the average healthcare facility company is growing at 5 to 7%.

ER: What about the risks?
LC: There are a lot of risks associated with this name but let's go through them. You've got shareholder litigation. Now we don't know how big this is going to be but most likely it will be resolved in the next two to three years. Next there are potential government fines from the Department of Justice, SEC and Medicare. Again, unknown magnitude but there have been rumors of a $200 million settlement with the DOJ. Moving on, there are no audited financials and additional fraud is possible. Finally, the company's outpatient business has been deteriorating but there are signs that 2004 could be the trough. All in all, most of theses risks are unquantifiable but we think the potential upside more than offsets the risk factors. Essentially the share price already reflects all the bad news.

ER: What advice do you have for students?
LC: Warren Buffett said it best. He said, "When you graduate, go work for someone you respect." I would add that you should also be patient and not be job hopper. I also think it's a good idea for young people to start off as analysts and to become very knowledgeable in accounting.

ER: Thank you very much Mr. Cooperman.

Please send comments or suggestion to Erabinoiwch04@gsb.columbia.edu

CBS Grateful for Class Gift

By Melissa Swift

News that the Class of 2004 gift would be an endowment to strengthen the Alumni Career Network was received happily by the administration. Alumni are, after all, both a key resource for and an important audience of the school. As Associate Dean for External Relations Marilyn Kohn explains, "This [gift] is one of the best ways to add value to our alumni network."

In fact, the gift addresses an always-crucial issue – lifetime career support – that has become especially important in these economically volatile times. Associate Dean for Special Projects Jace Schinderman notes, "this economic environment produces an uncertainty that makes the school's effort all the more relevant." The Class of 2004 gift will build on and expand services that already generate tremendous value for the school - as head of Career Services Regina Resnick puts it, "the involvement of the entire Columbia Community in supporting the job search efforts of our current students has been especially crucial during the recent downturn. A commitment to deepening that network will benefit all members of the Community in their business endeavors."

Moreover, the gift serves a real purpose in the school's continual growth and ability to adapt. Schinderman praises the gift's ability to create "momentum and critical mass…attracting more money and support" for an initiative – "many activities (Disorientation, the Social Enterprise program, etc) started with a few people thinking of an idea that then became institutionalized." Because the gift is an endowment, each year the proceeds can be used to develop strategic programs appropriate to that year's needs – addressing unforeseen challenges and allowing Career Services to be strategically nimble in their alumni efforts. All in all, the gift should play a central role in helping CBS students tackle the challenge of not just getting a job, but having a meaningful and rewarding career.