SINGULAR DILIGENCE

Hunter Douglas (Amsterdam: HDG)

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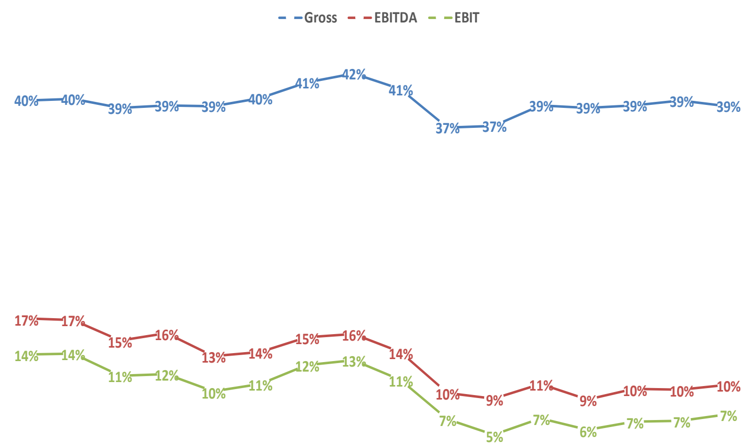
Stock Price: 38.63 EUR (42.29 USD)



	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Tachikawa	0.16	0.39	2.53	2.82	2.82
Colefax	0.54	1.00	5.97	8.49	8.49
American Woodmark	0.98	5.75	14.86	20.98	16.65
Masco	1.31	4.69	11.82	14.36	10.13
Sherwin-Williams	2.66	5.73	19.21	22.06	21.57
Minimum	0.16	0.39	2.53	2.82	2.82
Maximum	2.66	5.75	19.21	22.06	21.57
Median	0.98	4.69	11.82	14.36	10.13
Mean	1.13	3.51	10.88	13.74	11.93
STDEV	0.96	2.62	6.71	8.20	7.31
CV	85%	74%	62%	60%	61%
Hunter Douglas	0.73	1.88	7.00	9.88	6.82

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Min	Max	Median	Mean	STDEV	Variation
Sales	1,327	1,356	1,381	1,450	1,570	1,540	1,590	1,870	2,150	2,397	2,630	3,028	2,942	2,376	2,445	2,573	2,588	2,636	2,695	1,327	3,028	2,376	2,134	588	28%
Gross Profit				573	622	596	619	728	854	990	1,111	1,230	1,080	877	953	997	1,008	1,040	1,049	573	1,230	972	895	208	23%
EBITDA	224	225	240	249	268	230	249	250	296	366	411	416	283	214	257	230	258	261	282	214	416	257	274	60	22%
EBIT	173	175	188	196	214	175	183	182	226	299	341	331	203	126	172	149	172	178	200	126	341	183	204	58	28%
Receivables					319	341	372	359	341	436	570	695	752	640	563	542	551	541	520	319	752	541	503	136	27%
Inventory					436	444	370	321	318	423	585	677	687	634	614	634	663	659	641	318	687	614	540	138	25%
PP&E					346	364	352	321	292	356	478	572	623	612	590	582	585	572	529	292	623	529	478	124	26%
Working Liabilities					283	267	264	261	253	366	546	653	618	547	538	535	548	560	599	253	653	538	456	152	33%
Net Tangible Assets					818	881	829	741	698	850	1,086	1,291	1,444	1,339	1,229	1,223	1,251	1,211	1,091	698	1,444	1,091	1,065	241	23%
MARGINS																									
Gross Profit/Sales				40%	40%	39%	39%	39%	40%	41%	42%	41%	37%	37%	39%	39%	39%	39%	39%	37%	42%	39%	39%	1%	0.04
EBITDA/Sales	17%	17%	17%	17%	17%	15%	16%	13%	14%	15%	16%	14%	10%	9%	11%	9%	10%	10%	10%	9%	17%	14%	13%	3%	0.23
EBIT/Sales	13%	13%	14%	14%	14%	11%	12%	10%	11%	12%	13%	11%	7%	5%	7%	6%	7%	7%	7%	5%	14%	11%	10%	3%	0.30
TURNS																									
Sales/Receivables					4.92	4.51	4.27	5.20	6.30	5.50	4.62	4.36	3.91	3.71	4.34	4.75	4.70	4.88	5.18	3.71	6.30	4.70	4.74	0.64	14%
Sales/Inventories					3.61	3.47	4.30	5.82	6.77	5.66	4.50	4.47	4.28	3.75	3.98	4.06	3.90	4.00	4.20	3.47	6.77	4.20	4.45	0.92	21%
Sales/PPE					4.54	4.24	4.52	5.83	7.36	6.73	5.51	5.30	4.73	3.88	4.15	4.42	4.43	4.61	5.09	3.88	7.36	4.61	5.02	0.98	20%
Sales/NTA					1.92	1.75	1.92	2.53	3.08	2.82	2.42	2.35	2.04	1.77	1.99	2.10	2.07	2.18	2.47	1.75	3.08	2.10	2.23	0.38	17%
RETURNS																									
Gross Profit/NTA					76%	68%	75%	98%	122%	117%	102%	95%	75%	65%	78%	82%	81%	86%	96%	65%	122%	82%	88%	17%	0.19
EBITDA/NTA					33%	26%	30%	34%	42%	43%	38%	32%	20%	16%	21%	19%	21%	22%	26%	16%	43%	26%	28%	9%	0.31
EBIT/NTA					26%	20%	22%	25%	32%	35%	31%	26%	14%	9%	14%	12%	14%	15%	18%	9%	35%	20%	21%	8%	0.39
GROWTH																									
Sales		2%	2%	5%	8%	-2%	3%	18%	15%	11%	10%	15%	-3%	-19%	3%	5%	1%	2%	2%	-19%	18%	3%	4%	8%	1.92
Gross Profit					9%	-4%	4%	18%	17%	16%	12%	11%	-12%	-19%	9%	5%	1%	3%	1%	-19%	18%	5%	5%	10%	2.25
EBITDA		0%	7%	4%	8%	-14%	9%	0%	19%	24%	12%	1%	-32%	-24%	20%	-11%	12%	1%	8%	-32%	24%	5%	2%	15%	6.16
EBIT		1%	7%	4%	9%	-18%	5%	-1%	24%	32%	14%	-3%	-39%	-38%	37%	-13%	15%	3%	12%	-39%	37%	4%	3%	20%	6.91
Receivables					-1%	15%	4%	-10%	1%	54%	16%	27%	-7%	-23%	3%	-10%	15%	-16%	12%	-23%	54%	3%	5%	19%	3.72
Inventories					22%	-14%	-19%	-6%	4%	61%	24%	10%	-6%	-10%	4%	2%	7%	-8%	3%	-19%	61%	3%	5%	20%	4.00
PP&E					9%	1%	-8%	-10%	-8%	55%	21%	19%	0%	-4%	-4%	1%	0%	-4%	-11%	-11%	55%	0%	4%	17%	4.40
Working Liabilities					0%	-10%	9%	-11%	6%	81%	32%	10%	-20%	-1%	-2%	1%	4%	1%	13%	-20%	81%	1%	7%	24%	3.14
Net Tangible Assets					15%	2%	-13%	-8%	-3%	48%	14%	23%	3%	-17%	3%	-4%	8%	-14%	-5%	-17%	48%	2%	3%	17%	4.94

SINGULAR DILIGENCE

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Hunter Douglas (Amsterdam: HDG) is the Huge Hidden Champion in Blinds and Shades

OVERVIEW

Hunter Douglas trades in Amsterdam. The company's stock is priced in Euros. Financial statements are presented in U.S. dollars. The company gets 81% of sales from the U.S. and Europe. Sales are split almost evenly between the U.S. and Europe. North America accounts for 43% of sales. Europe accounts for 38% of sales. Hunter Douglas has two brands names. The U.S. brand is Hunter Douglas. The European brand is Luxaflex. All other parts of the world use either the Hunter Douglas or Luxaflex brand name.

Hunter Douglas is the world leader in window coverings. The company gets 68% of profits from window coverings. These are blinds and shades sold through an independent dealer network to consumers who live in houses and apartments. The company gets 24% of profits from architectural products. These are similar to window coverings. But they are sold to commercial customers instead. They include exterior shades, skylight shades, sun control systems, etc. They serve the same function as blinds and shades in homes. However, they are on a much bigger scale. A good example of a Hunter Douglas architectural products customer would be an airport. This segment is broken out separately in Hunter Douglas's results because the marketing is different. The manufacturing of components is similar in both cases. The type of products are fundamentally similar. But, the marketing is completely different.

Hunter Douglas gets about two-thirds of its profits from Hunter Douglas and Luxaflex branded blinds and shades sold through independent dealers. In the U.S., Hunter Douglas's manufacturing is now completely vertically integrated. Originally, the company had a model similar to many other building products companies. It manufactured components in a few plants around the country. Then it shipped these parts to hundreds or even thousands of independent fabricators across the country. The fabricators assembled the parts into finished products. The fabricators also nominated dealers for Hunter Douglas to review and approve. Over time, Hunter Douglas phased out this model. They acquired fabricators and cut out the middlemen. Now, Hunter Douglas deals directly with dealers. Hunter Douglas has completely consolidated its U.S. manufacturing. This means the company can fulfill orders much faster than competitors. A custom order can be fulfilled in one week in the U.S. Competitors can take 15 to 30 days to fulfill similar custom orders. Hunter Douglas handles all aspects of manufacturing from the making of components to final assemble itself. Both the manufacturing and assembly are done entirely in the U.S. Hunter Douglas does not import any products. The company has 8 manufacturing plants in the U.S. that produce components. These parts are then assembled into a custom order at one of three sites in Maryland, Utah, or California. So, the Hunter Douglas brand in the U.S. is manufactured in a vertically integrated way. It is made entirely in the U.S. And it has a one-step distribution process. Parts are manufactured in a plant. They are sent to a company owned fabricator and assembled into a custom order. They are then shipped directly to a Hunter Douglas dealer. Assembly and delivery can be done in one week.

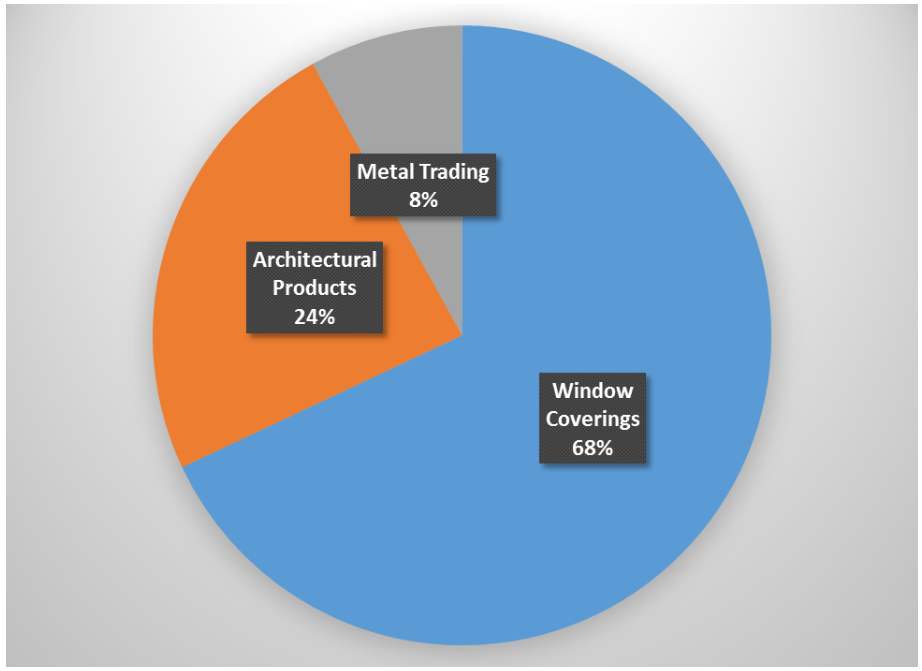
The Luxaflex brand in Europe is somewhat different. Parts are produced in a few plants. Manufacturing is centered mostly in the Netherlands. However, some Luxaflex orders are assembled by local fabricators instead of being put together in Hunter Douglas's own assembly plants. So, the Luxaflex brand in Europe follows the old Hunter Douglas model in the U.S.

Hunter Douglas is an obscure stock. The Hunter Douglas brand is American. So, the company's name is American. However, the stock trades in Europe. The company reports its results in U.S. dollars. But, the stock trades in Euros. The stock is 81% owned by the Sonnenberg family. Basically, the Sonnenberg family is the "Douglas" family. That's because there is no Douglas family. There never was a Douglas family.

Here's how Hunter Douglas was formed. In 1940, Henry Sonnenberg moved to the U.S. In 1946, Sonnenberg established a joint venture with Joe Hunter. They produced aluminum slats for Venetian blinds. Later, the Hunter Douglas corporation was created. The name Hunter came from Joe Hunter's name. The name Douglas was Sonnenberg's contribution. He thought "Sonnenberg" sounded too Jewish. So, he simply picked the name "Douglas" from a telephone book. Hunter Douglas became the U.S. leader in aluminum blinds. They sold parts to over 1,000 independent fabricators who assembled orders. In 1956, a falling out between Hunter and Sonnenberg led to the sale of the U.S. business. Sonnenberg continued in the window coverings business in Canada. He expanded throughout Europe, Australia, and Latin America. In 1969, Hunter Douglas went public. The stock was listed in Canada and the Netherlands. Sonnenberg moved the company's headquarters to the Netherlands. The headquarters are still in Rotterdam today. In 1976, Sonnenberg was able to buy his former U.S. business. This combined the U.S. and European operations.

Hunter Douglas is completely family controlled. The Sonnenbergs own 81% of the company. They wanted to take it private. However, their tender offers have never been accepted by enough minority shareholders to reach the threshold needed to de-list. Ralph Sonnenberg is the CEO of Hunter Douglas. Ralph is Henry Sonnenberg's son. Ralph's two sons – David Sonnenberg and Marko Sonnenberg – are co-Presidents and co-Chief Operating Officers of the company.

The Sonnenbergs treat the corporate cash like their own. In the past, the company invested in a variety of investment funds. At some point in the 2000s, Hunter Douglas stock was cheap and the Sonnenbergs probably wanted to take the company private. So, they used much of this built up investment money to buy back stock in Hunter Douglas. They were not successful in taking the company private. But, they did increase their stake in the company to over 80%. The company often has both debt and cash. Hunter Douglas never hoards cash. Instead, cash is used to buy back shares or is put into investment funds. Those funds performed very well compared to the market. The stock also pays a 3% dividend yield.



Hunter Douglas gets 68% of its total profit from window coverings

Financial assets are taxed differently in the Netherlands than in many countries. So, it is possible that tax considerations play some part in the way the Sonnenberg family allocates capital. This is a family controlled company with less than 19% in the hands of minority investors. So, capital will be allocated in the way that makes the most sense for the family.

You may recognize the Hunter Douglas brand. It advertises on TV channels like HGTV. The Luxaflex brand is probably unfamiliar to American readers. Hunter Douglas window coverings are either blinds or shades. Shades are more expensive. In 1992, a "Duette" shade cost twice as much as aluminum mini-blinds. And a "Silhouette" shade cost twice as much as a "Duette" shade. So, a "Silhouette" shade cost four times as much as aluminum mini-blinds. At the time, a Silhouette shade was the top of the line model for Hunter Douglas. So, this relative pricing is a good guide to keep in mind. A cellular shade – "ette" type – product can cost double what it costs to cover your window with a basic blind. And a top of the line model can cost double the low end of the range. Hunter Douglas now competes in all price ranges. The company is best known for its "ette" products. In 1985, they launched "Duette". In 1991: "Silhouette". In 1994: "Vignette". In 1996: "Luminette". In 2004: "Facette". And in 2007: "Pirouette". Hunter Douglas spends more on research and development than other competitors. It spends more on advertising than competitors. And it is always the first company to launch a new innovation in the market place. In the following years, other companies copy these innovations. Hunter Douglas has 38% market share in the U.S. Unlike its competitors, all Hunter Douglas sales are made through independent dealers. So, Hunter Douglas has a greater than 38% share of the independent dealer channel.

DURABILITY

The Historical Trend in Window Coverings is for Countries to Switch from Curtains to Blinds and Shades as their Economies Develop

The durability of Hunter Douglas depends on 3 things. One, the durability of customer preference for specially designed and manufactured shades and blinds over more basic window coverings like curtains. Two, the durability of domestically manufactured products over imports. And three, the durability of the independent dealer channel as a viable venue for selling window coverings. Customer preference is easy to predict here. Historically, it has been driven entirely by brands like Hunter Douglas. In countries where Hunter Douglas has little presence and little ability to get its "ette" products in front of home buyers – people are happy covering their windows with blinds. However, in developed countries like the U.S. and Europe where Hunter Douglas has had a strong presence for decades – the market share of curtains plummets. It is not too much of a stretch to compare this with the history of razors or batteries. There are some differences still to this day in the technologies used by consumers in certain countries for those products. These are almost entirely due to the limited presence of the most technologically advanced brands in those countries. Once consumers have enough money to afford advanced versions of a product and that innovation is advertised to them they will eventually switch to it. In fact, there is a lot of room around the world for additional sales of blinds and shades to replace curtains. For example, curtains are 95% of all window coverings in India. They are 45% of all window coverings in the U.K. And they are just 25% of all window coverings in the U.S. Of those 3 countries, the U.S. has the highest median household income and the strongest Hunter Douglas market presence. India has the lowest median household income and the weakest Hunter Douglas market presence. These two factors are the most likely explanation for why a country uses a lot of curtains or blinds or shades.

The use of retained earnings to invest in vertically integrated manufacturing of both parts and final assembly, one step distribution, automation to reduce labor, research and development to design new innovations, and advertising to launch the latest model are what drives adoption of more advanced technologies in window coverings. Again, products like razors and batteries are a good analog. More advanced versions of these products are pushed by big global brands that have highly automated plants, spend on researching new technologies, and heavily advertise the launch of their latest innovations. Without the presence of a cutting edge brand in the market, consumers are satisfied with products that were considered obsolete on other continents decades ago. This can be seen in window coverings. Consumers in India are quite satisfied with products that Americans considered basic even decades ago. Over time, developing markets should follow the same trends as developed markets to the extent the most innovative window coverings brands can penetrate those markets.

Because we don't think of window coverings as a high tech product, we may overlook that fact that some countries are several decades behind others in their adoption of innovations. In batteries, it is easy to understand that a country using mainly zinc batteries that were popular 100 years ago in the U.S. is "behind the times" but a country using curtains in place of cellular shades may seem like it is culturally different from other markets and simply prefers a different fashion. The evidence does not support this. Americans and Europeans do not prefer blinds and shades for cultural reasons. It is not a western fashion. It is simply that all the innovations in window coverings have been launched into the U.S. and European markets by a company focused on the U.S. and Europe. There is no reason to expect a trend away from blinds and shades. And there is every reason to expect that the more innovations are launched, the more customers can – over the decades – be shifted further and further along the high tech path.

The next threat to durability is imports. Is this a valid concern? Probably not. Hunter Douglas has a 38% market share in the U.S. It uses domestic production and assembly entirely. It does not make use of any imports. Hunter Douglas's biggest competitor is Springs. Springs sells through big box stores as well as independent dealers. This can create pressure to lower selling prices. Springs imports its standard products. About 70% of Springs products are custom made. The parts for these custom made products are all made in the U.S. Final assembly is done in Mexico. The other 30% of products are not custom made. They are fixed products. These are all imported from Asia. They are very low quality. And they are not sold to independent dealers. These fixed styles and sizes are sold through stores like Bed Bath and Beyond, Target, Wal-Mart, and K-Mart. This is a really small part of the business. It is for people who simply want to cover a window fast. Most of Springs business and all of Hunter Douglas's business does not cater to this group.

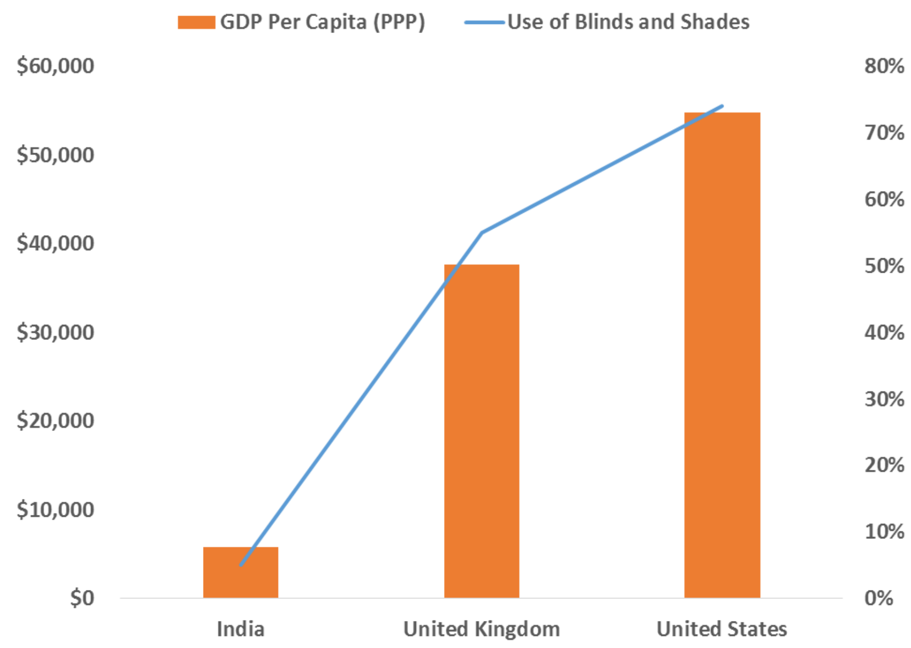
Hunter Douglas has no fixed business. And even Springs is mostly custom. As someone from Springs explained: "Custom products…are made to customer specifications, so it's impossible to say how many distinct models or types of shades, shutters, or blinds are offered…It's infinite…It's an eighth of an inch this way, an eighth of an inch that way. You pick the color, you give the dimensions, you say you need the cord on this side or that side. The bottom could go up, the top could come down. There are a lot of different options."

Making custom orders is complex. In Europe, Hunter Douglas still has a two-step distribution process. However, manufacturing parts for a custom product is complicated even when someone else assembles the order. A 2000 article in the

Financial Times explained this well: "The job of matching the production of parts with what the consumer wants adds up to a massive exercise in logistics. Every day, 10 to 15 trucks arrive at (Hunter Douglas's) central European warehouse near Rotterdam with parts from the company's six main European manufacturing units. These are mainly in the Netherlands, and produce items such as metal sheets, fixtures, textiles – and even paint used in the final finish...The individual components – made in some 10,000 different shapes and sizes – spend as little time as possible in the warehouse before being reshipped either to Hunter's 20 or so assembly plants around Europe or to other companies which can, under some circumstances, take over the assembly and distribution job under a licensing deal."

Hunter Douglas blinds and shades are sold by an independent dealer. This is someone – like a decorator – who is knowledgeable about the Hunter Douglas line-up and can offer fashion advice. About 80% of window coverings shoppers are women. The most important services offered by dealers to these women are measurement, installation, and fashion advice. Decisions need to be made on color, material, pleat or slat size, lifting system, etc. Dealers provide advice on this. They also provide warranties. Some dealers told us that customers return up to 20 years after purchasing a window covering looking for a repair.

In 2010, Hunter Douglas chose to double down on this independent dealer network. It decided to abandon all other sales channels. Here is the company's Vice President of Merchandising talking about that decision four years after making it: "It was a very big decision. Almost counterintuitive to what certain people think. But in June of 2010, we made that decision. Keep in mind that Hunter Douglas sells only custom order products, and it's more difficult to sell a custom ordered product online than it is to sell a (stock keeping unit)....(we) have multiple size options, and each



The United States has both one of the world's highest GDPs per capita and one of the world's highest (74%) penetration rates of blinds and shades.

size option has hundreds of colors. Plus, there are control options that are wide and varied and sometimes dependent on the size you order. So, it's a complex purchasing decision and we just didn't feel comfortable putting that totally in the hands of the consumer, who probably doesn't know a lot about it."

So, Hunter Douglas will live or die with the independent dealer channel. The biggest risks to the independent dealer channel are big box retailers like Home Depot and Lowe's, online retailers like blinds.com (owned by Home Depot), and franchises like Budget Blinds. Some Budget Blinds franchisees actually sell Hunter Douglas despite the fact they have less bargaining power on Hunter Douglas products – it is not part of the approved supplier list that corporate negotiates with on their behalf. This is probably due to the ease of selling Hunter Douglas products due to their heavy advertising. Younger and do-it-yourself customers can shop at Home Depot and Lowe's.

An executive at a window coverings company that sells through both independent dealers and big boxes said: "This is an 'influencer' assisted sale in most cases. There is a high risk of making an error because it is a custom made product, therefore, with limited staffing and high turnover the big box stores have struggled to take a larger share. However, (Home Depot) and Lowe's are both starting to focus more on the (Do it for me) customer through their shop at home programs. (J.C. Penny) always had an in home custom decorating program, but it is a relative new thing for (Home Depot and Lowe's). Therefore, there is a chance they could take more share from the traditional designer channel in the future."

Since 2000, Home Depot and Lowe's have increased their market share in the do-it-yourself paint category. This hurt Benjamin Moore which was focused entirely on independent dealers. However, Sherwin-Williams is still by far the largest paint company in the U.S. and it relies almost entirely on its own network of company owned paint stores to sell its product. Home Depot and Lowe's have both courted Benjamin Moore and Sherwin Williams hoping those companies would allow them to sell their paint. Benjamin Moore agreed to this and then Warren Buffett fired the CEO of Benjamin Moore for breaking his promised to independent dealers never to enter the big box channel. Sherwin Williams just recently announced its first deal with a big box store. Window coverings are a smaller and more customized category than paint. Hunter Douglas's market clout in window coverings is similar to Sherwin-William's in paint. Without access to Hunter Douglas products, it is not clear that Home Depot and Lowe's can sell enough window coverings to make it worth focusing on this category.

MOAT

Hunter Douglas is the Dominant Brand in the Independent Dealer Channel

A big part of Hunter Douglas's moat is its strength with independent dealers. Hunter Douglas sells just one brand in the U.S. and one brand in Europe. It only sells through the independent dealer system. So, it can invest more in advertising the Hunter Douglas brand in the U.S. And it can invest more in support systems for dealers. For example, Hunter Douglas has a website that customers can visit and make selections regarding product type, color, lifting system, etc. They see a picture as they make these decisions. Once the visitor has tested out the different Hunter Douglas products visually by browsing on the website, the traffic is routed to a dealer through a dealer locator. There is no other way to buy Hunter Douglas. So, the Hunter Douglas website only works to refer customers to dealers. This is a benefit to dealers who can get traffic from a website they themselves do not run. Hunter Douglas also offers more direct technical support by providing a pre-designed website. If you visit most Hunter Douglas dealers online, you can tell that the Hunter Douglas section of their website was obviously designed separately from the main site. If you go from dealer to dealer, you will see these Hunter Douglas sections are essentially the same regardless of which dealer's site you are on. Hunter Douglas provides a customer management program that allows dealers to take customer information, make appointments, etc.

A few dealers we spoke to started out selling all sorts of window coverings brands but now sell only Hunter Douglas. One dealer told us that other companies copied the Silhouette product from Hunter Douglas. This dealer used to sell those copycat products. The copycat product was cheaper. But, it would fray in a few years. The Hunter Douglas Silhouette would last a long time. So, this particular dealer decided to stop carrying the competing product that is meant as a cheaper alternative to Silhouette. The dealer explained that the quality of the sales they made were simply not as good.

Dealers – like blinds companies – rely on word of mouth. Several dealers told us that Hunter Douglas products have a higher initial cost than a competing product of similar appearance. However, the Hunter Douglas product lasts longer. The dealers believe this means the amortized cost of the Hunter Douglas product is lower on an annual basis. This is important because dissatisfied customers may return years later if a product frays. They may also refer business to the dealer if the product stays in good condition. In fact, Hunter Douglas tells its dealers that word of mouth is the most effective means of growing sales. One dealer told us that 80% of their business is from word of mouth.

A dealer who carriers Hunter Douglas, Levolor, and Graber told us that they usually buy all the brands they think their customers will need. But, they don't see Levolor or Graber as a possible replacement for Hunter Douglas products because Graber and Levolor can't match the service or premium quality of Hunter Douglas.

Another dealer told us that nobody else advertises the way Hunter Douglas does. So, it is a lot easier to sell Hunter Douglas products. People get Hunter Douglas because they have heard the name. It is a good experience for them. And then they tell their friends about it. So, the product is easier to sell.

A couple dealers we talked to actually stopped selling other brands. One used to sell other brands but then they just kept selling more and more Hunter Douglas so they decided to become a Gallery Dealer and then finally a Centurion dealer (selling Hunter Douglas exclusively).

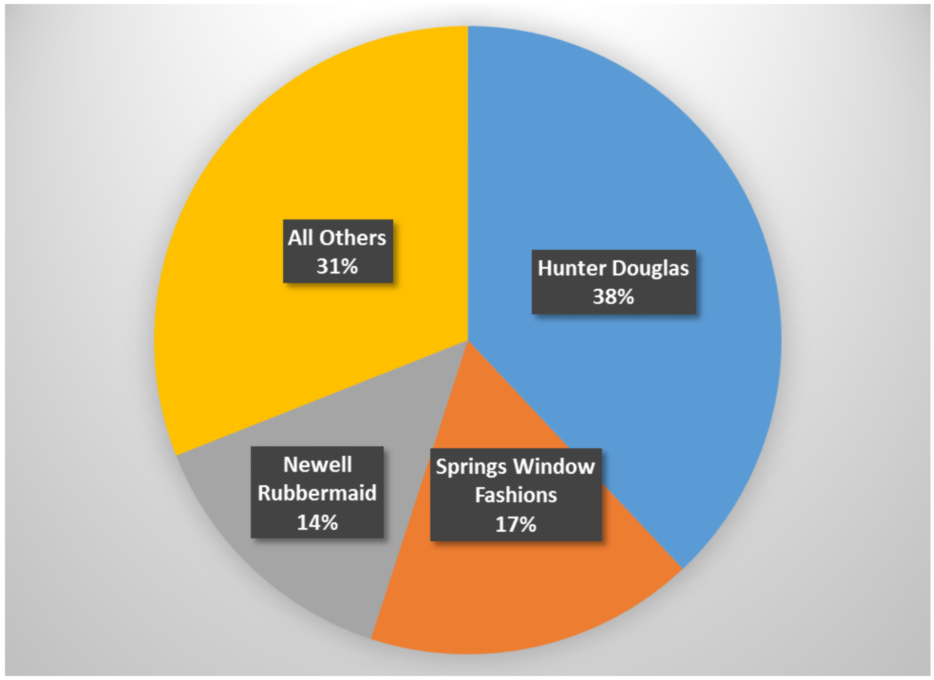
Another dealer explained the decision to go to selling Hunter Douglas exclusively was partly – but perhaps not entirely – financial. They said Hunter Douglas selection and quality was the highest. There were less issues for him and less customer dissatisfaction on his sales. Now, they only sell Hunter Douglas because it gives the customer a better time. It ended up this way simply because they sold more and more Hunter Douglas over time. This particular dealer told us he likes selling quality more because he knows the customer will have less problems in the future and they'll be glad for the quality. He's not sure that this approach makes the most money for him. In fact, he thinks he could probably make more money if he tried selling everything, but it wouldn't be as enjoyable a job and wouldn't be worth the effort just to make more money.

A different dealer who switched to selling Hunter Douglas exclusively told us they made the switch because other dealers don't offer the same support Hunter Douglas does.

One dealer who still sells the other brands but now gets 75% of sales from Hunter Douglas said the other brands have cheapened their quality to get into the big box stores. This dealer carries the other brands at lower price points meant for people who rent instead of own their home or who don't care very much about the long term. The implication here being that other brands have reduced the durability of their materials to achieve a similar look at a lower price – which is what big box stores tend to want.

Hunter Douglas is best known for its highest end products. A lot of dealers and customers talked about the Silhouette being something that others may copy but don't do well. It is an expensive product. But the quality there is unique to Hunter Douglas.

Hunter Douglas has scale advantages in research and development and brands. Research and development scale advantages are global. The company spends $35 million a year on R&D. It has 100 employees in R&D in the U.S. This $35 million is only about 1% of Hunter Douglas's global revenue. However, it would be more than 6% of Springs Window Fashions's total sales. Springs is the second largest window coverings company. Hunter Douglas's EBIT margin is between 10% and 14% in normal years. It was 5% in the worst year for the company which was 2009. Springs Window Fashions probably has a lower EBIT margin. Spending as much in dollar terms as Hunter Douglas on R&D could eat up most of the company's margin. For this reason, it is likely that Springs spends a lot less on R&D. The history of Hunter Douglas – not Springs – always being the company to introduce new innovations supports this hypothesis. Obviously, the Hunter Douglas brand in the U.S. has huge scale advantages. It is probably 3 to 4 times the size of the nearest competitor sold through the independent dealer channel. This scale is most obvious in signing up dealers. Dealers prefer selling Hunter Douglas because the company advertises which brings traffic to Hunter Douglas dealers. Finally, Hunter Douglas may have scale advantages in production. The company is fully integrated in the U.S. It manufactures parts and assembles custom orders itself. It then ships directly to dealers. Other window coverings manufacturers do not do this. Hunter Douglas doesn't do this in the European Union yet. It has been moving toward more integrated manufacturing there as well. It is possible that Hunter Douglas will one day organize its Luxaflex business in the European Union along the same lines it now runs its Hunter Douglas business in the U.S.



Hunter Douglas has 38% of the total U.S. market for blinds and shades

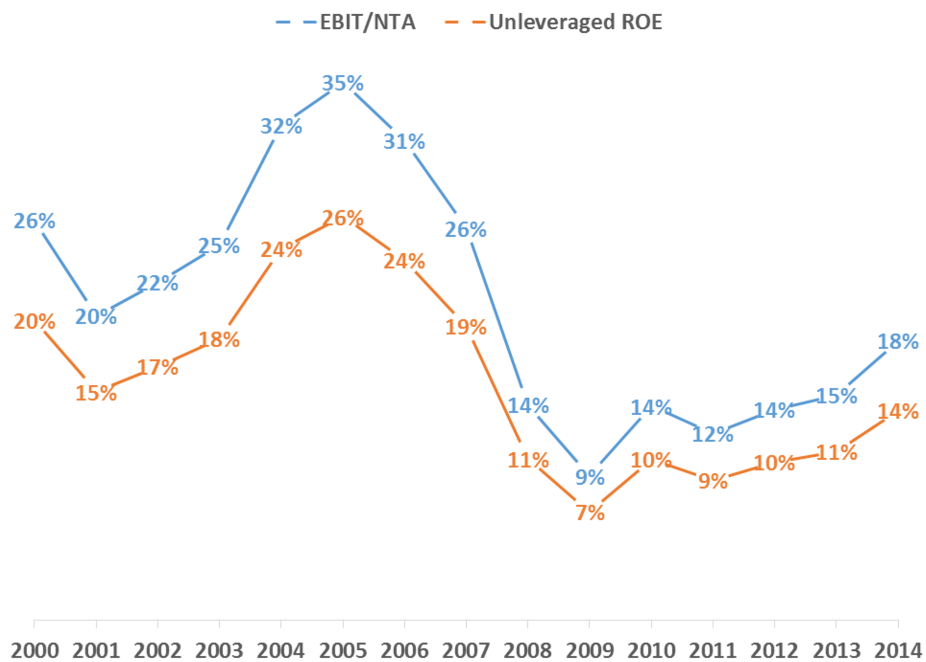
Overall, it is likely that Hunter Douglas invests more in "special" forms of capital like factories, dealer support systems, brand advertising, and research and development. Hunter Douglas is more specialized than competitors. Tasks like assembly and importing do not require much in the way of specialized capital. But factories that produce only parts for use in the company's own blinds and shades are a form of specialized capital. This is clear in Hunter Douglas's low sales relative to property, plant, and equipment. Sales are just 4.5 times property, plant, and equipment. In other words, it takes over $22 of property to produce $100 of sales. Since EBIT margins are 10% to 14%, that $100 of sales would produce $10 to $14 of pre-tax profits. In the U.S., such profits are taxed at 35% or higher. So, that means profits are in the $6.50 to $9 range on $100 of sales. Put another way, it takes at least $22 of fixed assets to produce $9 of after-tax profit. This is certainly a good return. So, the investment is worthwhile if the EBIT margin can be high. The EBIT margin can be high if Hunter Douglas has some of the lowest costs and Hunter Douglas customers have some of the highest willingness to pay. We have no detailed cost data for competitors. And it is impossible to make direct comparison. However, it is not unreasonable to believe that in the U.S. at least Hunter Douglas products probably have the lowest unit costs and the highest willingness to pay of any brand. Where competing products cost less this seems to be due to using cheaper materials not to any cost savings in manufacturing. So, Hunter Douglas's manufacturing is probably low cost. Its marketing certainly achieves the highest sale prices of any brand. This gives the company the highest profits to invest in R&D, marketing, specialized manufacturing, etc. It also lets Hunter Douglas buy out assemblers to move to a one step distribution system. There is little evidence for significant investment in this industry by competing companies. They seem to invest less in both tangible and intangible forms of industry specific capital than Hunter Douglas does. In this way, Hunter Douglas is similar to Ekornes (the Norwegian maker of Stressless recliners).

QUALITY

Hunter Douglas Should Earn At Least a 10% After-Tax Return on Equity – Without Using Debt – in All But the Very Worst Years of the Housing Cycle

Hunter Douglas is a good rather than a great business. The product economics of what the company does are not perfect. Hunter Douglas has a tremendously strong competitive position. And the blinds and shades business is a good business. Costs can be low and the willingness of customers to pay for the product can be high. So, margins can be good. This is especially true for the leading brand like Hunter Douglas. It has the most scale. It especially has the most relative scale. Hunter Douglas is the biggest brand in its industry and yet it sells to the smallest dealers. Meanwhile, some smaller brands sell through big box companies. This means that in interactions with suppliers, fabricators (in Europe), dealers, and competitors – Hunter Douglas's relative size advantage is bigger than its absolute size advantage makes it appear. Competitors that are smaller than Hunter Douglas are even smaller relative to the key firms they interact with. For example, some smaller brands than Hunter Douglas are sold through big box stores like Lowe's. Lowe's is a much bigger customer than any dealer that Hunter Douglas sells through. So, the bargaining position of Hunter Douglas in negotiations is often much stronger compared to the bargaining power of competitors in their negotiations than it would appear to be. Using the Michael Porter approach of breaking down an analysis of competitive position into two parts: the competitive position of the industry generally and the competitive position of the firm specifically – Hunter Douglas passes the specific competitive position test best. It has more trouble on the industry test.

The window coverings business is cyclical. It is important for investors to keep in mind that companies in cyclical industries tend to underperform companies in non-cyclical industries over the long-term. This is because of the errors that are possible in cyclical industries that are unlikely to happen in non-cyclical industries. Over capacity can be a problem in any industry. It is as bad a problem in theory in the beverage bottle business as the oil tanker business. However, demand for shipping oil around the globe can be volatile. Demand for soda is not volatile. For this reason, it is easier for a company to know it is building a beverage bottle plant that will add the appropriate amount of capacity to the industry not just for today but for several years down the road. When building an oil tanker this is harder to tell. The intent may be to build the correct amount of capacity into the industry to get a good return next year. But, next year's demand for shipping oil could be much higher than what it will normally be a few years down the road. Once the tanker is built, the supply will be there whether or not the demand will be there.



Hunter Douglas failed to achieve the pre-tax equivalent of a 10% ROE in 2009 and 2011 during a terrible housing bust in the United States

This can also be a problem in blinds and shades. Demand for blinds and shades depends in parts on renovation and remodeling and in part on new home construction. There is not a lot of business where people are changing their blinds without remodeling or renovating the room the blinds are in. This is especially true for Hunter Douglas blinds since they have a long lifetime. People do not buy blinds because they wear out. People buy blinds because they want a new look. They are bought for fashion reasons as part of moving or remodeling.

Obviously, people have been moving into new homes and remodeling old homes a lot less since The Great Recession. From 1996 to 2007, Hunter Douglas had excellent growth numbers. During the housing boom from 2002 to 2007, sales grew at a completely unsustainable rate of 14% a year. From 2007 to 2009, they actually declined 11% a year. And from 2009 through 2014, they grew at 2.5% a year. Sales in 2014 were below the sales peak set in 2007.

Hunter Douglas did not reduce capacity during this time. The same factories make the same parts and do the same assembly they did before. Hunter Douglas also had much the same fixed spending on advertising. As a result, gross margin declined by about 3% of sales and marketing and sales costs rose by about 3% of sales. In other words, EBIT margin fell by about 6% of sales for no reason other than a change in the amount of volume being done. This is because margin absorbs the fixed costs of factories and ad campaigns at a higher unit rate when fewer units are sold. There is no evidence of changes in either the costs or prices of Hunter Douglas products if sold at the same volume as moved through the system back in 2007. But, that level of unit volume has never been achieved since 2007.

In the years since 2007, Hunter Douglas made a 14% pre-tax return on capital. This is equivalent to a 9% return on equity without using debt. That is a good estimate of the worst cyclical performance Hunter Douglas is likely to have. At no point is the company likely to do worse than a 9% a year return on equity. This is because the years 2008-2014 were the worst years for people moving into new homes and renovating old homes in close to a century. That 6 year period is – if not quite a once in 100 years event – certainly a once in every 50 years event. You are unlikely to have such a depressed housing market in the U.S. more than once every half century or so. And Hunter Douglas still managed to earn about a 14% pre-tax return. That is about a 9% ROE after-tax. In other words, the company should earn close to 10% a year on equity even in bad times.

That is a good performance for a cyclical company. The problem is that the performance in good years is not that much higher. Hunter Douglas earned a 26% pre-tax return on capital from 1996 through 2007. This includes the not normal at all housing boom of 2003 through 2007. However, it also includes the years 1996 through 2002, which were pretty normal years. Some were good. Some were bad. Housing was fairly normal during that time. Thinking of Hunter Douglas as a full cycle business that includes good stretches like 1996 through 2007 and bad stretches like 2008 through 2014, we can say that unleveraged returns on equity might be as low as 9% in bust years and as high as 17% in non-bust years. Boom years might do even a little better. But, that's not what matters. What matters in a long series of compound returns is the range of likely annual results. That range is 9% to 17%. It might seem that 13% is a good – even conservative – estimate of what Hunter Douglas can earn on its equity over the truly long-term. Maybe. But one problem is that when compounding returns there is a tendency for the bad years to pull the return further from the rate enjoyed in the good years because compounding is not an arithmetic operation. If you look at averages that include the arithmetic mean, geometric mean, and harmonic mean you'll notice the two non-arithmetic means are always lower than the arithmetic mean. We don't talk about this much in investing. But it is important for long-term investors to keep in mind. In a series of compound annual results where the lowest figures are a lot lower than the mean – the mean will likely be higher than the actual compound annual return. Hunter Douglas's median return on equity should certainly be 13% a year or better. The range of returns should be in the 9% to 17% a year range. However, returns could be pulled down toward the 10% to 13% a year range due to the cyclicality of the business. There will always be some bad years.

Hunter Douglas will return at least 10% a year after-tax on its equity. This makes it an acceptable long-term investment. The company can also use some leverage if it chooses. Even in 2009, Hunter Douglas did not lose money. If it didn't lose money then it can support some debt at all points in the cycle.

Hunter Douglas can move to a one-step distribution process – cutting out fabricators who assemble orders for Luxaflex in Europe – which would reduce receivables. This would not require a change in inventories because inventories have to be high due to the need to have parts on hand to quickly assemble custom orders. A switch in the European business model would reduce the need for receivables without much increasing the need for inventories. This would free up more capital. So, return on equity could be higher in the future than it was in the past in Europe. Also, the years 2008 through 2014 could be so long and so bad a housing depression in the U.S. that the entire period from 1996 through 2014 may actually understate full cycle profitability. That is unclear. It certainly doesn't overstate it. I am confident Hunter Douglas can achieve a 10% to 15% a year return on equity after-tax without using any debt. That return should be good enough to make Hunter Douglas stock an acceptable buy and hold investment.

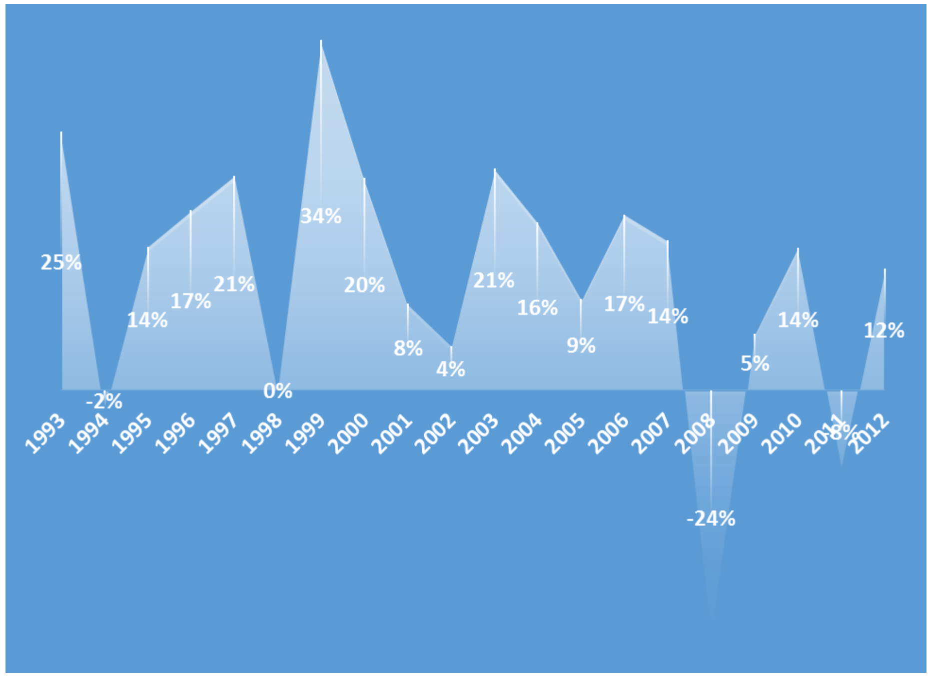
CAPITAL ALLOCATION

The Sonnenbergs Treat Hunter Douglas's Money Like Their Own Money

The Sonnenberg family runs Hunter Douglas like they own all of it. They actually own about 81% of the company. Hunter Douglas is a public company. It is actually a pretty big public company. But capital allocation should be thought of here as if it were a private company. The Sonnenbergs do not build up net cash in the company. They try to compound the value of the stock in any way possible over the long-run. And they try to lower the amount of taxes that are owed. They are obviously focused on long-term after-tax growth in the intrinsic value of what they control. This can be achieved in several different ways.

Generally, there is strong evidence that organic growth in the Hunter Douglas business creates value. Any reinvestment in the blinds and shades business is a move that should benefit shareholders over time. The acquisitions of companies related to blinds and shades are also a good move for shareholders. Hunter Douglas is a serial acquirer. These are vertical mergers. Since 2001, Hunter Douglas has spent $684 million on 51 different acquisitions. That makes the average acquisition size $13 million. The most common type of acquisition was a fabricator. A fabricator is an assembler of window coverings further downstream from the company. So, for example, in the U.S. Hunter Douglas has long made parts for its custom orders but it used to have other local companies assemble these parts into finished orders. Buying out these assemblers brings more of this downstream business into the company. So, Hunter Douglas becomes more vertically integrated. It especially gets them closer to dealers.

Other mergers were component makers. Component makers are upstream from Hunter Douglas. Hunter Douglas makes blinds and shades. It can buy parts it needs and it can sign deals with fabricators that allow them to assemble Hunter Douglas orders. It can also produce parts in house and assemble orders in house. Over time, Hunter Douglas has expanded in both directions. It has gotten bigger in the parts business – which means it makes more and more of its inputs. And it has gotten bigger in the fabricator business – which means it makes more and more fully finished outputs. This lengthens the whole chain of production that is being done inside the company. This is a pretty important thing to consider because these are custom orders. Bringing more of the part production and fabrication in house can allow for greater control over the finished product. When we say a part maker we really just mean an input that is used by the blinds and shades business. For example, Hunter Douglas bought Kendix in 2005. Kendix is a Dutch fabric maker. In 2005, they also bought Mermet. This is a maker of glass fiber and sunscreen fibers. In 2007, they bought ESI. ESI is a maker of motor controls used in blinds and shades. They also bought Hexcelscreen which is similar to Mermet in that it makes things window covering companies use as screens in their shades.



From 1991 through 2012, Hunter Douglas's investment portfolio returned 11% a year

Hunter Douglas also buys companies that make new window coverings products. In 2007, the company bought a maker of translucent architectural material. That same year they bought a German company that makes terracotta facades. And in 2010, they bought a metal ceiling manufacturer in Argentina. Remember that Hunter Douglas gets 24% of its profits from architectural products. These are very similar to the shades and blinds business. However, they are meant for commercial customers on larger projects with somewhat different needs for covering their windows, providing shade, etc. The example we gave earlier of airports is a good one. You can see how the sorts of acquisitions mentioned above can relate to Hunter Douglas's existing architectural products business.

Hunter Douglas usually pays a low price for acquisitions. It's hard to value these acquisitions because while we have sales data or can use employee data and knowledge of the industry to guess at price-to-sales ratios, we do not usually have good acquisition price to pre-tax earnings data. We don't know the EV/EBITDA that Hunter Douglas generally pays. We also think EV/EBITDA is unimportant here. Hunter Douglas is usually buying a company they already do business with as a supplier to them or a buyer from them. Once the company is brought in house, the EBITDA will change. In other words, the EBITDA benefit once the acquired company is integrated into Hunter Douglas can be quite different from what the acquired company had itself been reporting in EBITDA as a small standalone operation that was either supplying Hunter Douglas or buying from Hunter Douglas. We can, however, say with certainty that Hunter Douglas often paid 0.5 times sales or less for the companies it acquired. So, if the company had a 5% EBIT margin, the price would be 10 times EBIT or less. Often, it could be a lot less. Prices paid in 2012 and 2013 seem quite low. It's possible that private companies sold for unusually low prices from 2008 through 2014. So, Hunter Douglas may not get another chance to do acquisitions at such low prices. This makes measuring the value creation of acquisitions close to impossible. It makes sense to acquire businesses from 2008 to 2014 on the assumption of a recovery in housing in the U.S. However, until that recovery in housing occurs, no benefit to EBIT will appear. So, buying at a low EV/Sales ratio could mean buying at a high EV/EBIT ratio because margins are so poor in bad times. But, if EBIT of the industry rises faster than sales in a housing recovery than paying a low EV/Sales ratio today means getting a lot of future EBIT for a small amount of present day EV. We know Hunter Douglas has always paid pretty low EV/Sales ratios for its acquisitions. We also know the acquisitions are very, very closely related to what Hunter Douglas already does. They simply move the company a little further upstream or downstream in terms of greater vertical integration. Hunter Douglas is a lot more vertically integrated today than it was during the housing boom. However, until there is a recovery in housing it may be difficult to assess how much vertical integration really benefits the company.

The Sonnenberg family amassed a huge investment portfolio for Hunter Douglas. They started putting some of Hunter Douglas's free cash flow into the portfolio in 1991. The portfolio ran from 1991 to 2012. It peaked at $849 million in 2007. Over the 21 years from 1991 to 2012, the portfolio return 11% a year. It returned 14% a year from 1991 to 2007 and then declined from there. Hunter Douglas picks outside fund managers to invest in a range of different asset classes, industries, geographies, and currencies. It only gives 0.5% of the fund to a new manager. It then ramps up the investment with that manager over time if results are good. This leads to wide diversification. We have no idea how Hunter Douglas made 11% a year from 1991 to 2012. It seems reasonable to assume the company used offshore hedge funds. But there isn't a lot of detail about this. The company just started up an investment portfolio again. There is no reason to assume it can do as well as the last one did. It is best to assume the investment portfolio will match the market over time or underperform a little due to fees. But, it is worth mentioning that the Sonnenberg family does not build up cash. The company had net cash from 2004 to 2007. Otherwise, it always had some net debt. Right now, Hunter Douglas's net debt is 1.5 times EBIT. This is manageable. The company is usually quite liquid because it keeps a lot of gross debt and gross cash (or investment securities) on hand at all times. Hunter Douglas won't have idle cash in the future. It might use some debt to leverage up its return on equity. And any excess cash it doesn't pay out in dividends will probably end up in investments that are made in markets similar to the worldwide stock market. Returns on "cash" will therefore be closer to 6% a year than 0%. It's unlikely they will comes close to the 11% a year Hunter Douglas made from 1991 through 2012.

The exact way Hunter Douglas allocates cash is a little complicated. It is probably done for tax reasons. The company tends to put offshore profits into its investment portfolio (instead of repatriating the earnings). It then uses debt when it wants to pay dividends, buy back shares, or acquire something. Over time, the net debt position does not rise much. And net debt relative to EBIT doesn't rise. But gross debt may often rise because the company doesn't want to pay any taxes it doesn't have to. So, it avoids repatriating earnings simply to have access to cash.

The Sonnenberg family would obviously like to take Hunter Douglas private. The top 3 executives are members of the family. The CEO is the son of the founder. His two sons – grandsons of the founder – hold the tile of Co-President and Chief Operating Officers. So, the Sonnenbergs have the 3 top positions in the company and 81% of the stock. It's almost a private company already. But, Hunter Douglas has been public since 1969. The Sonnenbergs would need to buy out minority shareholders to go private.

In 2008, Hunter Douglas offered to buy 13.4 million shares at 43 Euros a piece from minority shareholders. Only half of the desired shares were tendered. So, 6.7 million shares stayed in the hands of outside shareholders. This raised the family's control from 68% to 81%. The company spent $463 million on the buyback. These funds were taken from the investment portfolio. So, the family basically swapped other financial assets for the core Hunter Douglas operating business.

There is some danger the company will go private at a price that is not near the intrinsic value of the stock. It still seems like a good buy and hold investment. If the family buys out investors, it can be a good short-term investment. If the family does not buy out investors, it can be an excellent buy and hold investment. The risk is getting bought out at below intrinsic value – below our appraisal price for the stock – rather than below the price you would pay for the stock.

Hunter Douglas pays a dividend. It peaked at 2 Euros per share in 2007. From 2010 to 2014, it was 1.25 Euros a share. The stock has paid a dividend in each of the 46 years it has been publicly traded. Except for the crisis, the general trend is to maintain the dividend each year with it rising a bit over time. In 2009, the company also paid a special dividend. Again, this is evidence of unusual capital allocation caused by the family behaving as if this is a private company.

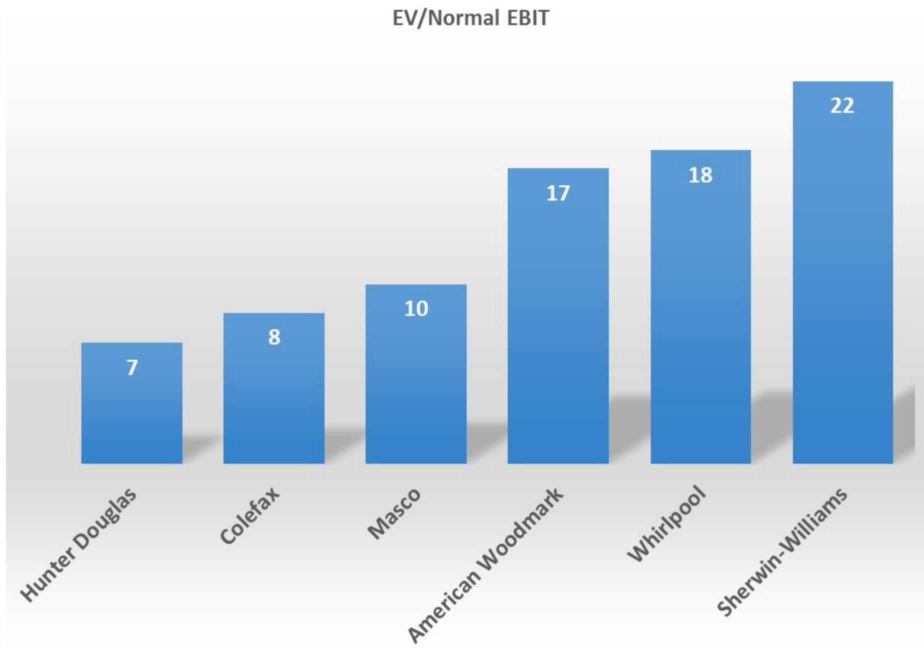
Overall, there is a risk of the company going private below its intrinsic value. Minority shareholders may suffer from an unfair price. However, the Sonnenberg family allocates capital very well. As a long-term buy and hold investor, you can expect well above average capital allocation from Hunter Douglas. Share dilution is virtually non-existent. Capital allocation will add value here – it will not destroy it.

VALUE

Hunter Douglas is Much Cheaper than All of its Possible Peers

Hunter Douglas reports in U.S. dollars. It is very important that you as a reader keep this in mind if you are interested in buying Hunter Douglas stock. The stock is quoted in Euros. However, you must – at the time you are considering your purchase – convert the stock price from Euros into U.S. dollars. The values we give for the stock will be in dollars. You should imagine you are buying the stock in dollars. However, on the day you buy the stock you will need to buy it in Euros. We will not be converting dollar financial statements into Euros here. There is a good reason for this. Hunter Douglas does not get most of its sales in Euros. So, although the stock is quoted in Euros – it is inappropriate to imagine valuing the business in Euros. The business must be valued in dollars. And then you must make your purchase decision by converting the stock price as shown in Euros into a stock price in dollars. The exchange rate between Euros and dollars will change from the time I type this on the screen now till the time the issue is released till the time you are reading this issue and finally till the time you actually put in a buy order. There is no way for us to anticipate what the exchange rate between the U.S. dollar and the Euro will be on the day you want to place a buy order. So, we will not be doing any translating of dollars to Euros here. We will appraise the company in dollars. You will then have to reimagine the stock price as being in dollars when you place your buy order.

So, let's look at Hunter Douglas in dollars. The company has $565 million in debt and $219 million in cash. The market cap is $1.6 billion. The enterprise value is just under $2 billion. Current EBIT is about $200 million. So, the EV/EBIT is about 10 times. Keep in mind that because the Dutch corporate tax rate is lower than the U.S. corporate tax rate and because Hunter Douglas avoids paying taxes wherever possible – the company's after-tax P/E



Despite being over 25 times bigger, Hunter Douglas is cheaper than Colefax – an illiquid U.K. microcap stock that makes luxury furniture fabric and wallpaper

will tend to be lower than the P/E of a U.S. company with the same EV/EBIT. An EV/EBIT of 10 could translate into a P/E of 13. This is especially true if – as is often the case at Hunter Douglas – there is some amount of net debt.

The important thing to keep in mind when valuing Hunter Douglas is that the company made $200 million pre-tax last year but will make $300 million pre-tax in a normal year. None of the years from 2008 through 2014 were normal for U.S. housing. The economy in Europe was not especially strong either. Hunter Douglas's U.S. business (which would normally be close to half of sales) is as tied to the U.S. housing market as companies like Masco, Mohawk, etc. Hunter Douglas is earning well below its potential EBIT. The company's enterprise value to normal pre-tax earning power is less than 7. The numbers are roughly $2 billion in enterprise value divided by $300 million in normal EBIT equals 6.7 times EV/EBIT. The company's tax rate could be as low as 25% in the Netherlands. That would make the P/E 9. It is safe to assume Hunter Douglas is trading for no more than about 10 times after-tax earnings. This is especially true because the company tends to add a little leverage through having net debt in most years. So, if we ignore the results from 2008 to 2014, and simply ask what the price and quality of this company would be in a perfectly "normal" year – I think we can say this is a stock with a return on equity of at least 13% trading at a P/E of no more than 10.

Now, let's compare Hunter Douglas to some of its peers. The peers we have chosen are Colefax, Masco, American Woodmark, Whirlpool, and Sherwin-Williams. Sherwin-Williams is a great business – in fact, it's a better business than Hunter Douglas – and a very expensive stock. It's too expensive a stock actually. The stock trades for 22 times EBIT. A slight adjustment for the amortization of intangibles brings this a little closer to 21 times EBIT. We are talking about 30 times after-tax earnings here. Sherwin-Williams is a great company. It may be a good long-term investment. But, we can't honestly suggest it is worth buying at a P/E of 30. This is an off the charts peer that we are just going to ignore. Sherwin-Williams is a better business than Hunter Douglas. And Sherwin-Williams has often been much cheaper than 20 times pre-tax earnings. So, we can't say that Hunter Douglas should have a price remotely as high as Sherwin-Williams does now.

Whirlpool is not a better business than Hunter Douglas. Whirlpool is less cyclical. And the possibility that Electrolux could buy GE's appliance business – if the Department of Justice is not successful in blocking this deal – could reduce competition in the industry. But, measures of historical profitability favor Hunter Douglas over Whirlpool. Whirlpool trades at 16 times current EBIT and 18 times "normal" EBIT (the company's operating margin is a bit high at the moment).

Masco trades at 14 times current EBIT. But, only 10 times normal EBIT. This normal EBIT is calculated by taking today's sales and multiplying by the long-term average EBIT margin. This may or may not be appropriate in Masco's case. It may be the case that sales – not just margins – are significantly understated. Regardless, Masco's price is actually higher than Hunter Douglas's price. Masco trades for 10 times normal EBIT while Hunter Douglas trades for just 7 times normal EBIT. It's possible that Masco – as a whole – is a pretty good peer for Hunter Douglas. Masco's paint and plumbing businesses are good. They could be better than Hunter Douglas. The other businesses are inferior to Hunter Douglas. This could be a good peer. But, so could Whirlpool. So, at the moment, we have about 10 times normal earnings for Masco and about 16 to 18 (depending on whether you think today's margins are here to stay) times EBIT for Whirlpool. These are two decent peers for Hunter Douglas. So, that's an appropriate range to think about for Hunter Douglas.

American Woodmark trades at 17 times normal EBIT. This is a very cyclical business. It is not as good as Hunter Douglas. Again, this may be an off the charts reading here we should disregard. Hunter Douglas and American Woodmark are both closely tied to housing. But the quality of American Woodmark is not high and yet the price is high. I'm not sure we can trust the market on this one either. So, we will ignore both American Woodmark and Sherwin-Williams as reasonable peer valuations here.

Colefax makes luxury furniture fabrics and wallpaper. It is a small (the market cap is under $100 million U.S.) U.K. listed company. This is a very good peer for Hunter Douglas in terms of the product being interior decorating related. However, it has much lower growth than Hunter Douglas. Since 2000, it grew only 1.5% a year. For that reason, Hunter Douglas should probably have a higher EV/EBIT multiple than Colefax. Colefax's current EBIT is 8.5 times. This is a bit lower than Hunter Douglas's 10 times current EBIT. But, Colefax's results are not cyclical. So, cyclically adjusted EV/EBIT may be lower at Hunter Douglas than at Colefax. Colefax is very illiquid. It trades a little over $10,000 U.S. per day. Perhaps the lack of growth since 2000 and the illiquidity lead people to ignore this company.

So, there are 3 reasonable peers for Hunter Douglas. Colefax trades at less than 9 times normal EBIT, Masco trades for 10 times normal EBIT, Whirlpool trades for around 15 times normal EBIT. Meanwhile, Hunter Douglas trades for about 7 times normal EBIT. As a group: Colefax, Masco, and Whirlpool are not a superior basket of businesses than Hunter Douglas. Hunter Douglas should trade in at least the same range as these stocks.

To give some perspective, Hunter Douglas made $340 million at its peak in 2006. So, the enterprise value to peak EBIT is $2 billion divided by $340 million or just 6 times peak pre-tax profits. Although I don't like using bubble earnings as a starting point, Hunter Douglas is a bigger company almost 10 years later. It has acquired things. There has been a bit of inflation. The next time housing performs normally, it would be perfectly reasonable for Hunter Douglas to make $350 million a year at the mid-point – not the peak – of that cycle. With a 25% tax rate, that would actually give the stock a P/E under 8.

Roughly speaking, the current EBIT and P/E would be 10 times EBIT and 13 times P/E. Our favorite method for normalizing – which is today's sales times the long-term average EBIT margin – would be 7 times EBIT and 9 times P/E. The peak EBIT price would be 6 times EBIT and 8 times P/E. I am not sure which of these is true. Hunter Douglas will eventually pass its prior peak. But, I'm not sure when. The 10 times EBIT and 13 times P/E figure is clearly wrong. Housing is still performing poorly relative to what it will normally be in the U.S. A good estimate is that Hunter Douglas is probably selling for no more than 7 times the annual pre-tax profits it is likely to earn in the next housing cycle. In fact, this is an understatement. So, I'm confident the stock is trading for no more than 10 times normal after-tax earnings.

GROWTH

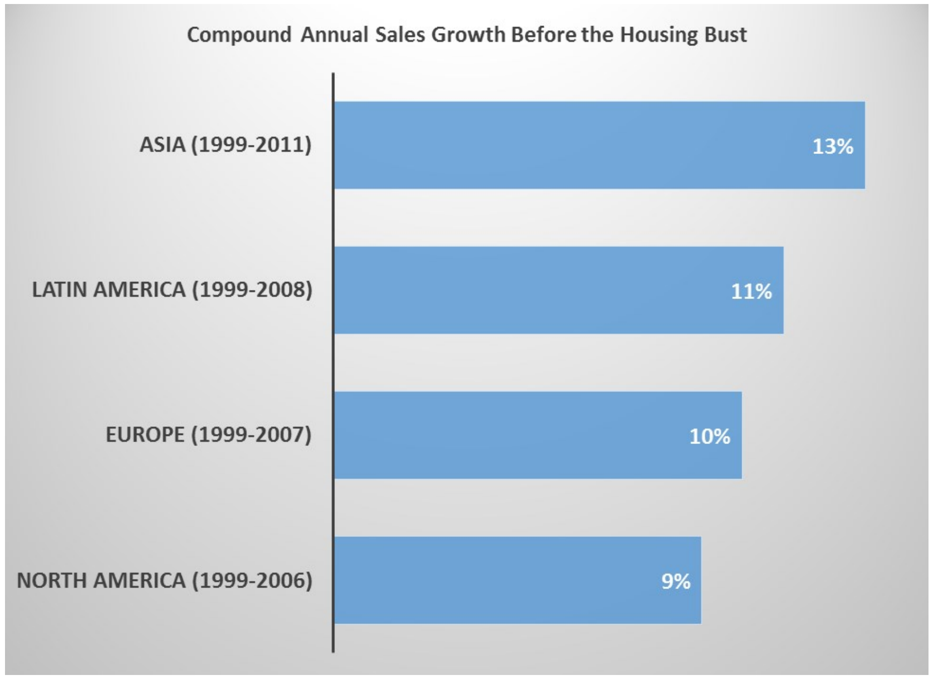
Hunter Douglas Can Grow 4% a Year in the U.S. and Europe – And a lot Faster in its Much Smaller Markets Around the World

Over the 18 years from 1996 to 2014, Hunter Douglas grew sales by 4% a year. There is no reason the company shouldn't be able to match this rate over the next 18 years. North America revenue is now 17% below its 2006 peak. European revenue is 20% below its 2007 peak. Sales can rebound faster from cyclically low levels than they would from a peak. The Great Recession in window coverings is still ongoing. Hunter Douglas's sales and earnings are lower than their peak. And they have been lower for close to a whole decade now. This is unusual. Normally, a company like Hunter Douglas would achieve a new record in sales and earnings in far less than 10 years. It is important to keep the depressed levels of the last several years in mind when looking at Hunter Douglas. The company's EBIT figure appears to be $200 million. However, it was $300 million at the last peak. Likewise, the company's 18-year sales growth record appears to be 4% a year. However, it was much higher for the period from 1996 through 2006. Some of this period was a housing boom. But even more of it was a housing bust.

Hunter Douglas will not achieve the kind of growth it had during the last housing boom. From 2002 to 2007, North American sales grew 14% a year. This was in line with the extraordinarily high levels of growth in other new home and renovation driven product sales. Hunter Douglas may not have a period of such fast growth ever again. That housing boom was a once or twice a century event.

But, it followed a flat period from 2000 to 2002. This is a typical pattern for Hunter Douglas. There is no reason to believe that Hunter Douglas's recent results are due to either a loss of market share in blinds and shades or to a decrease in homeowner appetite for blinds and shades. All of the decline seems to be cyclical. There are simply fewer people moving into new homes or renovating their existing homes. That is when most blinds and shades are sold. They are part of the moving or renovating process. That process has slowed to one of its lowest levels in history. At some point, Hunter Douglas's sales will be able to rebound quickly as renovating and homebuilding activity picks up. For a short time, this will mean above nominal GDP sales growth for Hunter Douglas.

In more mature markets like the U.S. and Europe, Hunter Douglas should be able to grow sales around nominal GDP. In Europe, there can still be room for blinds and shades to take greater share of window coverings. For example, the U.K. is still behind the U.S. in terms of how popular blinds and



Hunter Douglas's biggest market (the U.S.) is its slowest growing while the company's smallest market (Asia) is its fastest growing

shades are. Hunter Douglas adds new innovations to the top of its line. This allows the average cost for covering a window to keep pace with inflation as the quality of the window coverings used tends to improve over time. Again, this is similar to the razor business.

Developing markets tend to use curtains. Quan lives in Vietnam. He knows that most Vietnamese windows are covered with curtains rather than blinds or shades. In India, curtains have 95% market share. In the U.K., they still have 45% of the market. In the U.S., they have just 25% market share. Flipping that around so we look at it from Hunter Douglas's perspective – only 5% of the Indian window coverings market is penetrated by the technologies Hunter Douglas competes in. Only 55% of the U.K. market is penetrated by the technologies Hunter Douglas competes in. And fully 75% of the U.S. market is penetrated by the technologies Hunter Douglas competes in. Over time, there can be higher growth in developing markets as Hunter Douglas – and others – convince people to adopt European and American practices when it comes to window coverings.

The past record supports this. From 1999 to 2008, Hunter Douglas grew its Latin America sales by 11% a year. From 1999 to 2011, Hunter Douglas grew its Asian sales by 13% a year. The figures I am giving you here are a little different than the ones you will see summarized by the company. I have broken out window coverings sales from architectural product sales. Hunter Douglas is quite strong in architectural product sales around the world. Its share of window coverings bought by individual households is a different story. Hunter Douglas is much stronger in the U.S. and Europe than elsewhere in the world. Blind and shade technologies are not nearly as important outside of Hunter Douglas's key historical markets of the U.S. and Europe. But, Hunter Douglas has the best technology and manufacturing in these products. So, it should be in the best position of anyone to grow in markets like Latin America and Asia if households there can be convinced to buy blinds and shades instead of curtains.

The U.S. and European markets are mature. There can be some shift to blinds and shades. And Hunter Douglas's competitors seem to be focusing less on dealers and more on big national retailers like Lowe's and Home Depot. Hunter Douglas's competitive position in the U.S. and Europe is good compared to what it was before the peak of the housing bubble. But, market share is high. Hunter Douglas has 38% market share in the U.S. And Hunter Douglas only sells through independent dealers. There are some sales made through other channels. That means Hunter Douglas's share of independent dealer sales – the only channel in which it chooses to compete – is higher than 38%. While there is no theoretical ceiling on a company's market share – this is already awfully high. Hunter Douglas's market share in blinds and shades is really not that far from Sherwin-Williams's position in paint. It would be wrong to anticipate further market share gains. This is especially true because Hunter Douglas is limited to the independent dealer channel.

We don't have as much competitive information about the European market. Overall, there is more room for Hunter Douglas to acquire fabricators and move to more of a one-tier distribution model like it has in the U.S. Also, European competitors may not be as strong as U.S. competitors. There may be more opportunity for market share gains in Europe. But, this is complicated by there being many different countries and cultures in Europe. It's possible Hunter Douglas could grow faster in Europe than the U.S. if it gains more market share and if countries like the U.K. shift their buying habits to match U.S. households. However, Europe has some demographic challenges that makes it even slower growing than the U.S. It is probably best to assume an overall 4% annual sales growth rate for both the U.S. and Europe. Right now, Hunter Douglas gets 81% of its sales from the U.S. and Europe. So, if those markets grow at just 4% a year – the company can't grow much faster than 4% a year.

Other markets can and probably will grow a lot faster. GDP growth in developing markets can be higher. And if Hunter Douglas does a good job penetrating these markets, it could actually grow faster than GDP because these countries currently use so many curtains. There can be a one time societal shift from almost all curtains to mostly blinds and shades.

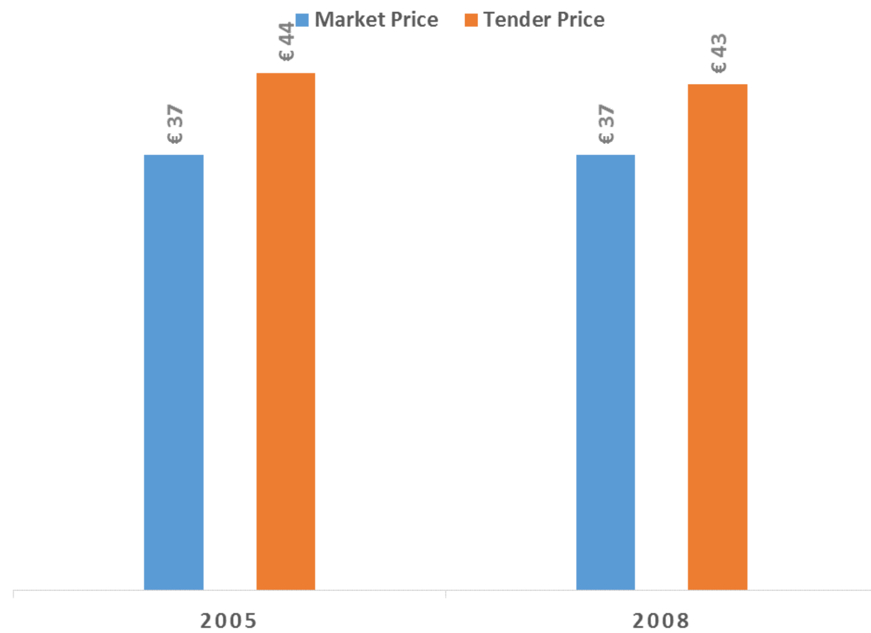
You shouldn't expect Hunter Douglas to grow more than 4% to 5% a year long-term. Annual sales growth equal to the nominal GDP growth rate of the U.S. and Europe seems completely doable. Sales growth will be much faster at some point in the future. But, this will be a one-time recovery back to the old 2006-2007 peak. Putting aside a return to the old peak numbers, it is reasonable to expect 4% annual growth from that peak forward.

MISJUDGMENT

The Sonnenberg Family Might Take Hunter Douglas Private at a Small Premium to the Market Price of the Stock

The most likely negative outcome for shareholders of Hunter Douglas is that the Sonnenberg family takes Hunter Douglas private at a low price. The family increased their ownership from 53% to 72% of shares outstanding in 2005. In 2008, the family further increased its ownership from 72% to 81%. They wanted to buy more. In both cases, the premium paid to the minority shareholders who were selling out was around 20%. This is not a high takeover premium. It is not unusual for a strategic buyer in the U.S. to pay a 30% premium to acquire a competitor. In both cases where the Sonnenberg family bought shares of Hunter Douglas, they paid a relatively low premium. The 2005 purchase was targeted at a 24% premium to the last closing price and a 17% premium to the three month average closing price. The 2008 deal was done at a 17% premium to the stock's last closing price.

If the Sonnenberg family manages to own 95% of the stock, it can delist in Amsterdam. The procedure for doing this is a squeeze out. An Amsterdam court decides what a fair price is. Usually, any price agreed to by 90% of shareholders is assumed to be a fair price. However, this is not the case when one of the shareholders who owns virtually all the stock is buying out the minority shareholders. The fair price is determined differently in this situation. The Netherlands has different laws than the United States. The way boards and courts work in the Netherlands may not provide the same protections to minority shareholders as would be the case in the United States. The big risk here is probably that the stock trades at a low price and the Sonnenberg family offers to buy out minority shareholders while the price is low. For example, the stock is now trading at a price that is probably more than 30% lower than the intrinsic value of the stock. This is easy to see if you look at the prior peak earnings of the company. Taxes in the Netherlands are lower than in the U.S. A company of Hunter Douglas's quality that is headquartered and listed in the Netherlands should trade for at least 10 times its pre-tax profits. Recently, pre-tax profits were just $200 million. However, peak pre-tax profits were close to $300 million. Hunter Douglas has at least as great a presence in the U.S. and Europe as it did at the peak in those markets in 2007 and 2008 respectively. In fact, Hunter Douglas has bought more companies since then. So, it should have as great earning power in the next cycle as it did in the past cycle. Both the U.S. and E.U. housing markets are below their long-term potential. They are actually both below their prior peaks in terms of nominal – and, of course, real – sales of window coverings. At some point, Hunter Douglas definitely will make more than $300 million in pre-tax profit again. It doesn't need



The Sonnenberg family only paid an 18% premium over the market price to raise its ownership of Hunter Douglas from 53%

to do anything competitively to reach that point. It just needs to maintain the competitive position it has had for the last decade in the U.S. and E.U. and then wait for those housing markets to recover. Shareholders may not be patient enough for that.

If you look at Hunter Douglas stock compared to its peers – this is obvious. The fact that Hunter Douglas is a U.S. brand name and yet trades in Amsterdam coupled with the Sonnenberg family's 80% control of the stock has made it a sort of hidden champion. In the U.S., investors are very aware of the bad housing market. Peers that sell cabinets, carpets, faucets, paint, dry wall, etc. trade at prices that anticipate what their earnings will be at a normal point in the next housing cycle. These companies – and homebuilders – trade at high prices relative to their earnings in the recent past. That is because investors in the U.S. are very aware of the terrible housing market since 2007. They know that 2008-2014 results are wrong. And they aren't capitalizing those earnings. They are looking at estimates of what normal earnings should be in the future.

This is not what is happening at Hunter Douglas. American investors probably aren't paying as much attention to this stock. It is a big American brand and a big European brand (Luxaflex) but it is listed in Amsterdam. It does not show up on screens for U.S. companies. The multiple on Hunter Douglas's current earnings is not high. The multiple on Hunter Douglas's peak earnings is incredibly low. These multiples are not cyclically correct. The company is very, very cheap compared to peers who depend on U.S. housing for their sales.

This mispricing in the stock creates a potential problem for long-term buy and hold investors. Hunter Douglas would be a great buy and hold investment. If bought today and held for 15 years, it will provide better annual returns than U.S. peers. There is little doubt of that. But there is a big doubt as to whether a minority investor who buys the stock today will be able to hold it for 15 years.

For the last 10 years, the Sonnenberg family has been interested in taking Hunter Douglas private. They may or may not be able to do this. And now that they own 81% of the company it may not matter as much to them to reach 100%. They have already increased their ownership by nearly 30% over the last 10 years. Getting the last 19% might be hard. It could be expensive. The company has been public for more than four decades. So, the family doesn't have a problem running a public company. It's also a big company. There isn't a lot of money that could be saved relative to earnings by delisting. The costs of being a public company are not that great when you are talking about a company that now makes $200 million a year pre-tax and once made $300 million pre-tax. If normal earning power is $300 million and the costs of being a public company add $3 million a year, delisting would add just 1% to the company's intrinsic value. The Sonnenberg family would have to pay a premium to take over the company. The premium would be closer to 20% than 1%. For a 20% premium to be worthwhile, you'd need to have costs as a public company in the many tens of millions of dollars range. That is nowhere near what it costs to be a public company. A private company the size of Hunter Douglas has many of the same costs as a public company. Once a company is this big, you don't save a lot by delisting.

So, the real reason for taking the company private would be getting the other 19% for yourself. Hunter Douglas stock is cheap. At today's price, the Sonnenberg family could simply borrow and pay something like a 30% premium for the remaining 19% of the company – and in the long-run, they'd come out ahead on that deal. Even an offer of 30% above the recent stock price would not destroy value. And the company can support some more debt. Debt is also cheap right now. So, if the Sonnenbergs wanted to make an offer of 30% or so higher than the stock price to take out all the remaining shareholders and most shareholders were willing to take that deal – it would benefit the buyers more than the sellers. It's actually not a good deal to take a 30% premium on the current stock price. It's better to simply hold the stock long-term.

And there is no reason to believe a premium would have to be that big. A 20% premium was effective in getting many minority shareholders to sell out in the past. Most investors are too focused on the market price of a stock instead of the intrinsic value. An offer that is 20% higher than today's market price would actually be below intrinsic value.

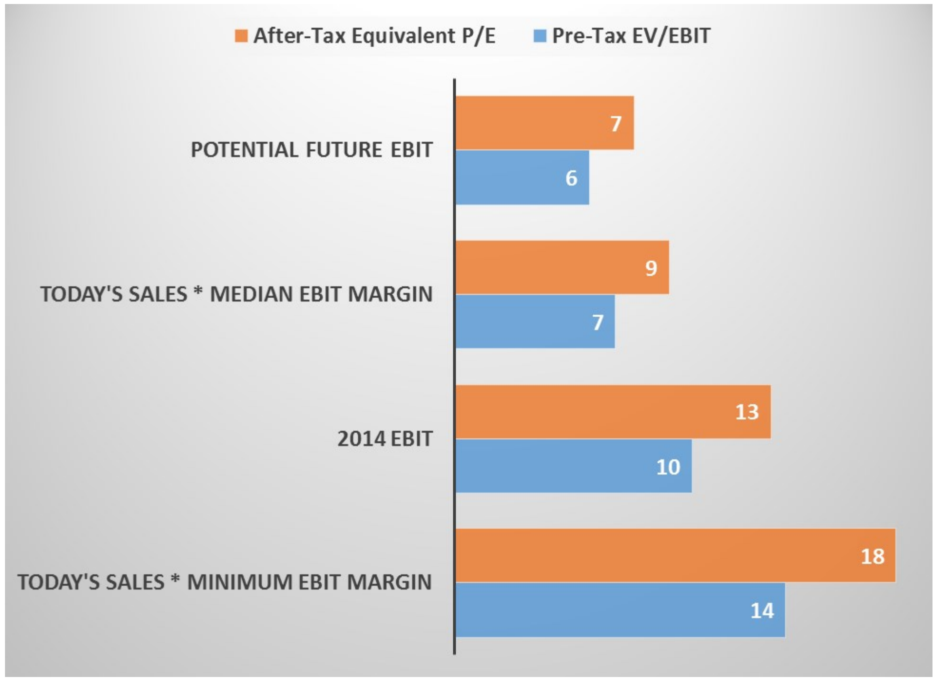
So, there is a risk that shareholders could be squeezed out. They might have to settle for a small one-time gain in Hunter Douglas stock instead of getting a buy and hold investment.

Investors who buy Hunter Douglas today should hope to hold it for the long-term. And they should definitely reject any offer the Sonnenberg family makes to buy them out. Hunter Douglas's intrinsic value is much, much higher than the current market price of the stock. Value investors should only accept offers made at a premium to intrinsic value – not just a premium to the stock's market price.

CONCLUSION

Hunter Douglas is a Good – Not a Great Business – Trading at a P/E of 10 Times its Normal Future Results

Hunter Douglas is a good business at a great price. Its competitive position is very strong. The company is the clear market leader in blinds and shades in the U.S. and Europe. It is a hidden champion within its niche. However, the product economics of blinds and shades are not excellent. They are not as good as paint. Sherwin-Williams has a similar position to Hunter Douglas. But, Sherwin-Williams can make a higher return on equity over time. Hunter Douglas's return on equity is acceptable. It is reasonable to expect Hunter Douglas to make a 9% to 17% return on equity each year without the use of debt. Good years for housing related products will be closer to a 17% return on equity. Bad years – like 2009 – will be close to a 9% return on equity. The key fact here though is that Hunter Douglas should – without using any debt – be able to make a 10% after-tax return on equity in almost every year regardless of the housing cycle. This is an adequate return if the stock is bought at a low enough price. It is fine for a buy and hold investor to buy a stock with an unleveraged return on equity as low as 10% to 15% a year as long as there are very few years below a 10% return on equity. Hunter Douglas should have almost no years with a return on equity under 10%. This makes it a good business. But it is not a great business. So, it needs to be bought at a great price to offer great returns.



Hunter Douglas trades for 9 times its normal after-tax earnings

Hunter Douglas's price is truly great. The stock has a 3% dividend yield. It trades for 13.8 times enterprise value to minimum EBIT. This is a measure of today's sales multiplied by the lowest EBIT margin in the company's last 20 years of results. It is a very conservative measure. Using the tax rate Hunter Douglas tends to pay, a 13.8 times EBIT is a P/E of just 18.4. That is not a low P/E. But, that is using a very conservative approach to valuation. It is almost certain that the company is trading for no more than 18 times the worst future year of earnings it will ever have. A lot of stocks now trade for about 18 times their best year of earnings.

The stock trades for 10 times its current EBIT. This is a P/E of 13. That is not a bad price. An EV/EBIT of 10 times and a P/E of 15 are about normal in most stock market environments for an average company. Hunter Douglas is a better than average business in the sense that it has a clearer future. However, its return on equity may be no better than average for a public company. This means that Hunter Douglas is trading at a fair price relative to today's earnings.

But, we know today's earnings are too low. The company made $200 million in EBIT last year and $300 million at the top of the housing bubble. Hunter Douglas has bought more businesses since then. The population of the U.S. and Europe (to a lesser extent) has increased since then. And there has been some inflation. There is no reason why Hunter Douglas will not reach and exceed its past peak in earnings. It's easy for some people reading this to fail to understand how certain this is. Because the prior peak was a housing bubble it may seem that Hunter Douglas will never repeat that performance. But, consider that in 2006, the U.S. had a population of 298 million people. Today, it has a population of 321 million people. Also consider that $1 in 2006 terms is now $1.17 in today's money. This means that if real spending on blinds and shades is the same per person in the United States over time the market is now 26% bigger in nominal terms than it was in 2006. Of course, the actual amount of buying in any one year will not match 2006 because that was a peak. But, it is worth keeping in mind just how far below the prior peak and any normal amount of sales activity the window coverings industry is seeing right now. If the number of people per household was not dropping and the amount of real spending on blinds and shades per window was the same you would see 25% higher spending on blinds and shades in normal times today than you did in normal times 10 years ago. Instead, you are actually seeing lower spending on blinds and shades now than you did at the peak. This gives you some idea of both how big the peak was and how low the level of spending on new homes and renovations is right now. Europe is actually further from its prior peak than the U.S. This is because the U.S. dropped more than Europe in terms of spending on products related to homebuilding but then recovered more rapidly. It is very important to consider how cyclically depressed Hunter Douglas's results are right now. The company's EBIT margins are lower because Hunter Douglas operates the same manufacturing capacity regardless of the amount of physical volume it does and because the company spends a lot on advertising its brand regardless of the amount of sales it does in any one year.

One of the best measures of earning power – and my personal favorite – is simply to take the long-term median EBIT margin for a company and apply it to today's sales. Now, obviously, this understates the potential future EBIT for Hunter Douglas because sales are depressed right now – not just margins.

But, let's pretend that was not true. Let's pretend today's sales figure is "normal" but the future margin will be the median margin the company recorded from about 1996-2014. Using this median margin approach, we get a price of 6.7 times EBIT. That is just under 9 times after-tax earnings. In other words, Hunter Douglas appears to be trading for a P/E of about 13 but is actually trading at a P/E of 9 if we use normal margins instead of today's cyclically depressed margins.

Even this may overstate the company's price. It is possible that given growth in other markets since the 2000s housing cycle and the acquisition of other businesses plus the impact of population growth and inflation in the U.S. and Europe – that Hunter Douglas can really earn more like $350 million in the future. That would give the company a price of less than 6 times EBIT and less than 8 times normal after-tax earnings. Any reasonable adjustment for cyclicality will give you a P/E using normal earnings of 10 or less. So, here we have a stock with a 3% dividend yield, a P/E of 10, an ROE of 13%, and a growth rate of 4%. Those are not overly optimistic assessments. It's possible growth could be better than 4%, ROE could be higher than 13%, and it might even be likely that the price to normal earnings is less than 10 times on an after-tax basis. The P/E estimate of 10 is probably high. The 13% ROE and 4% growth rate are good estimates. A good business that can earn an adequate return on equity without using debt and can grow at the same rate as nominal GDP while paying out a decent dividend yield should trade for 15 times normal after-tax earnings. Hunter Douglas trades for 10 times normal after-tax earnings. Those are the two key facts. It seems very likely that Hunter Douglas's future in terms of profitability and growth and durability will be about as good as the overall stock market. Meanwhile, it seems very likely that Hunter Douglas is trading for no more than 10 times normal after-tax earnings. So, you have a stock that is equal to the indexes in terms of its normal financial results. And yet it trades at a P/E of 10 instead of the more normal 15 times earnings. This means you can buy Hunter Douglas at a deeper than 30% discount to intrinsic value. So, while Hunter Douglas is merely a good – not a great – business, its low price makes it a great buy and hold stock.

Hunter Douglas (Amsterdam: HDG)
Appraisal: 100.66 USD (91.51 EUR)

Margin of Safety: 53%

Hunter Douglas Owner Earnings	*(in millions)*
Pre-tax Owner Earnings	
2014 Revenue	$2,695
* Normal EBIT Margin	11%
= Pre-tax Owner-Earnings	$296

Business Value

Hunter Douglas's business value is $3,848 million.

- Normal pre-tax owner earnings are $296 million
- Fair multiple = 13x normal pre-tax owner earnings
- $296 million * 13 = $3,848 million

Fair Multiple

Hunter Douglas's business is worth 13x pre-tax owner earnings

- An average business deserves 15x after-tax owner earnings
- Hunter Douglas is a high quality global franchise
- But Hunter Douglas is of lower quality than Sherwin-Williams
- Sherwin-Williams deserves 20x after-tax owner earnings
- Hunter Douglas deserves 17.5x after-tax owner earnings
- Tax rate is below 25%
- 17.5x after-tax owner earnings is equal to 13x pre-tax owner earnings

Share Value

Hunter Douglas's stock is worth $103.54 a share

- Business value is $3,848 million
- Cash and investment portfolio is $219 million
- Debt is $565 million
- Equity value is $3,502 million
- $3,848 million + $219 million – $565 million = $3,502 million
- Equity Value = $100.66/share
    - 34.79 million outstanding shares
    - $3,502 million / 34.79 million = $100.66

Margin of Safety

Hunter Douglas's stock has a 53% margin of safety.

- Business Value = $3,848 million
- Enterprise Value = $1,821 million
- Discount = $2,023 million ($3,848 million – $1,821 million)
- Margin of Safety = 53% ($2,023 million / $3,848 million)

	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Tachikawa	0.16	0.39	2.53	2.82	2.82
Colefax	0.54	1.00	5.97	8.49	8.49
American Woodmark	0.98	5.75	14.86	20.98	16.65
Masco	1.31	4.69	11.82	14.36	10.13
Sherwin-Williams	2.66	5.73	19.21	22.06	21.57
Minimum	0.16	0.39	2.53	2.82	2.82
Maximum	2.66	5.75	19.21	22.06	21.57
Median	0.98	4.69	11.82	14.36	10.13
Mean	1.13	3.51	10.88	13.74	11.93
STDEV	0.96	2.62	6.71	8.20	7.31
CV	85%	74%	62%	60%	61%
Hunter Douglas (Market Price)	0.73	1.88	7.00	9.88	6.82
Hunter Douglas (Appraisal Price)	1.39	3.59	13.37	18.87	13.00

ABOUT THE TEAM

Geoff Gannon, Writer

Geoff is a writer, blogger, podcaster, and interviewer. He has written hundreds of articles for Seeking Alpha and GuruFocus. He hosted the Gannon On Investing Podcast, The Investor Questions Podcast, and The Investor Questions Podcast Interview Series. He wrote the Gannon On Investing newsletter in 2006 and two GuruFocus newsletters from 2010-2012. In 2013, he co-founded The Avid Hog (the predecessor to Singular Diligence) with Quan Hoang. Geoff has been blogging at Gannon On Investing since 2005.

Quan Hoang, Analyst

Quan is a stock analyst. Quan won first prize in Vietnam's National Olympiad in Informatics in 2006. He graduated from Manhattanville College in 2012 with a B.A. in finance and a minor in math. In 2013, Quan co-founded The Avid Hog (the predecessor to Singular Diligence) with Geoff Gannon.

Tobias Carlisle, Publisher

Tobias Carlisle is the founder and managing director of Eyquem Investment Management LLC, and serves as portfolio manager of the Eyquem Fund LP and the separately managed accounts.

He is best known as the author of the well regarded website Greenbackd, the book Deep Value: Why Activists Investors and Other Contrarians Battle for Control of Losing Corporations (2014, Wiley Finance), and Quantitative Value: a Practitioner's Guide to Automating Intelligent Investment and Eliminating Behavioral Errors (2012, Wiley Finance). He has extensive experience in investment management, business valuation, public company corporate governance, and corporate law.

Prior to founding Eyquem in 2010, Tobias was an analyst at an activist hedge fund, general counsel of a company listed on the Australian Stock Exchange, and a corporate advisory lawyer. As a lawyer specializing in mergers and acquisitions he has advised on transactions across a variety of industries in the United States, the United Kingdom, China, Australia, Singapore, Bermuda, Papua New Guinea, New Zealand, and Guam. He is a graduate of the University of Queensland in Australia with degrees in Law (2001) and Business Management (1999).

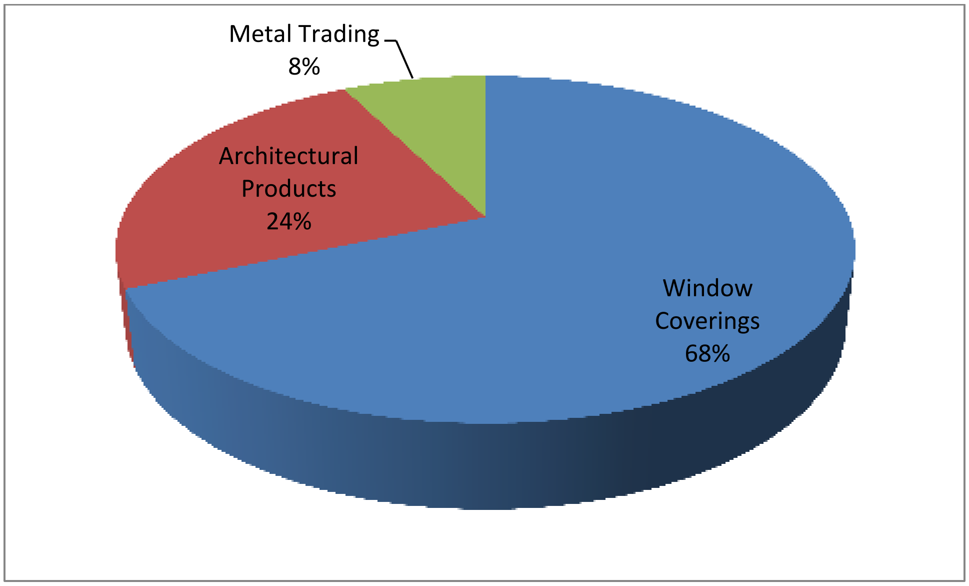
SINGULAR DILIGENCE

NOTES

Hunter Douglas (Amsterdam: HDG)

Overview

Hunter Douglas: an Obscure Global Franchise



Window coverings contribute 68% of Hunter Douglas's operating profit

- Hunter Douglas (HD) sells
    - Window blinds and shades: **68%** of profits
        - Window blinds
            - Composed of slats or vanes
                - Made of
                    - Wood
                    - Faux wood
                    - Woven wood
                    - Aluminum (mini-blinds)
                    - Fabrics
                    - Vinyl
            - Slats or vanes can rotate from a open to close position
                - For privacy and light control
                - Can be adjusted or tilted at different angles
                    - To adjust the amount of light needed
        - Window shades
            - Made of materials on a continuous roll
            - Fit snugly into the window
            - Stack neatly at the top

            - Shades offer a smooth look to windows
            - Shades can be drawn top-down or bottom-up
                - To adjust the amount of light needed
                    - Without giving up privacy
            - Can't adjust for light filtering like blinds
                - But you can choose the level of opacity when choosing a shades
            - Window shades offer
                - The same soft quality as curtains
                - The concise and controlled appearance of blinds
    - Architectural products: **24%** of EBIT
        - Sells to commercial customers
        - Sun-control solutions
            - Manage heat and light inside and outside windowed walls
            - Products include
                - Exterior shades
                - Skylight shades
                    - For horizontal and sloped glazing spaces
        - Ventilated Façade system
            - Uses lightweight aluminum skins
                - Attached to a honeycomb aluminum core
                - Provides extreme strength and flatness
            - Panels available in many shapes and curves
        - Suspended ceilings
            - Metal ceiling systems
            - A wide variety of designs and applications
                - Including curved and specialty shapes
            - Deliver
                - Superior noise reduction
                - A clean, monolithic look
- There's a favorable trend for window blinds and shades
    - People switch from curtains to window blinds and shades overtime
    - HD had grown nicely up until the financial crisis
        - 1996-2007 annual revenue growth was **8%**
            - 1996: $1,327 million
            - 2007: $3,028 million
- HD makes a wide range of window covering products

- From low end to high end
- HD is best known for their “ette” products
- Duette honeycombed shades
    - Revolutionized the pleated window-coverings market
    - Soft, attractive plated shades could be sold to fashion-conscious consumers
    - A three-dimensional, honeycombed fabric shade
        - Controls light
        - Offers excellent properties of energy efficiencies
            - Trap air in the cell to create insulation
    - Launched in 1985
    - Made $300 million revenue in 1988
    - Duette shades captured 60% of the pleated shade market
        - In the U.S.
        - By 1989
    - Many competitors copied Duette
        - Their products are called cellular shades
- Silhouette
    - Silhouette took Duette one step further
    - Light-adjustable soft fabric veins
    - A three-dimensional shade
    - Consists of woven, colored polyester fabric veins
        - Suspended between two sheer polyester knit facings
    - Veins can be opened or closed to control light
        - Offer privacy
    - Offers the best features of
        - Curtains
        - Blinds
        - Shades
        - All wrapped into one product
    - Benefits of Silhouette include
        - UV-protection
            - Even when the vanes are open
        - Reflect the sun heat
        - Light control (rotate the vanes)
        - Transform bright light into soft light
            - Reduce blare

            - Energy efficiency
                - Insulation
            - Unobstructed views from the inside
            - Shield views from the outside
        - Launched Silhouette in 1991
            - There's no comparable product in the market
    - Other "ette" products are
        - Vignette
            - Launched in 1994
        - Luminette
            - Launched in 1996
        - Facette shades
            - Launched in 2004
        - Pirouette
            - Launched in 2007
    - HD is known for all these "ette" products
        - They advertise on cable TV
    - A typical aluminum mini-blind cost $50-75 a window
        - Duette sells at retail for $150-180 a shading
            - Silhouette sells for $300 a shading
        - (From an article in 1992, price should be adjusted for today $)
- HD has about 40% market share in the U.S.
    - Strong brand
        - Advertising
        - Words of mouth
    - Most customers know about the products when walking to dealer stores
- HD is a truly "glocal" business
    - Revenue breakdown by regions
        - North America: 43%
        - Europe: 38%
        - Latin America: 9%
        - Asia: 7%
        - Australia: 3%
    - HD has presence in more than 100 countries
        - 50 manufacturing
        - 75 assembly operations
        - Marketing organizations

- They have two brand names
  - **Hunter Douglas** for North America
  - **Luxaflex** for Europe
  - Either Hunter Douglas or Luxaflex for other regions
- HD makes custom products
  - Maintain local production
    - In Europe
      - Concentrate components in a few plants
        - Mainly in Netherlands
      - Assemble products in local fabricators
    - In North America
      - Parts are made in 8 manufacturing plants
        - Based in the U.S.
      - All assembling is done by 3 plants
        - Cumberland, Maryland
        - Salt Lake City, Utah
        - West Sacramento, California
    - Deliver custom orders in 1 week
- HD historically has a 2-tier distribution system
  - HD supplies components to fabricators
    - Several **thousands** of independent fabricators worldwide
    - 75 company-owned fabricators
    - Fabricators assemble and sell the products
      - Fabricators nominate dealers
      - HD review and select dealers
  - Dealers
    - Over 100,000 dealers around the world
    - Mom-and-pop operations
- HD switches to 1-step distribution system overtime
  - Acquire and consolidate fabrication
  - Work directly with dealers
- HD took over all fabrication in the U.S.
  - Continues consolidating in other markets

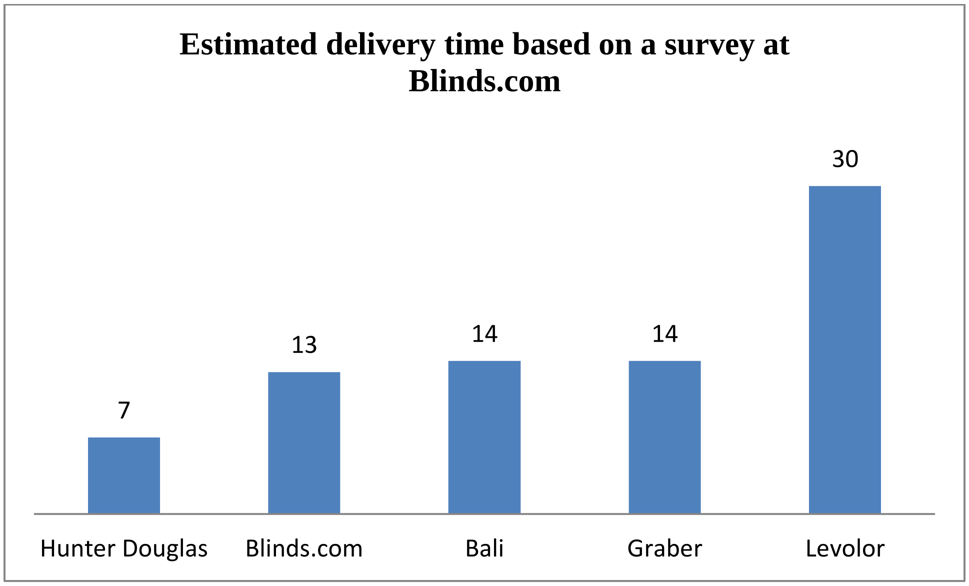
- HD is an obscure stock
  - HD has an American root
    - Henry Sonnenberg moved to the U.S.
      - In 1940

            - Founded the Douglas Machinery Company
        - Established a joint venture with Joe Hunter
            - In 1946
            - Developed "new technology and equipment for the continuous casting fabrication of aluminum"
                - Led to the production of lightweight aluminum slats for Venetian Blinds
            - The Hunter Douglas Corporation was established
                - Henry didn't want to use the Sonnenberg name
                    - Because it's Jewish
                    - He picked "Douglas" from a phonebook
        - HD aluminum blinds gained leadership in the US market
            - Built a network of more than 1,000 independent fabricators
                - Sold blinds during the day
                - Custom assembled blinds at night
        - Policy differences led to the sale of the US business
            - In 1956
        - Henry moved HD's headquarters to Montreal, Canada
            - Built the window covering business outside the U.S.
            - During 1960-1980, HD expanded in
                - Europe
                - Australia
                - Latin America
        - HD went public
            - In 1969
            - Listed on the Montreal and Amsterdam Stock Exchanges
        - HD's headquarters were moved to Rotterdam, the Netherlands
            - In 1971
        - HD reacquired its former U.S. business
            - In 1976
    - Today, HD is listed in Amsterdam
        - Uses $ as reporting currency
    - The brand in Europe is Luxaflex instead of Hunter Douglas
- The company is controlled by the Sonnenberg family
    - Owns 81.2% of total common shares
    - Ralph Sonnenberg is the CEO
        - Son of Henry Sonnenberg

- His two sons are Co-President and COO
  - David Sonnenberg
    - 48 years old
  - Marko Sonnenberg
    - 45 years old
  - Both have been active in the company for over 20 years
- HD is very cheap
  - Made $200 million adjusted EBIT in 2014
  - Made $341 million in 2006
  - Most housing products companies are still recovering from the financial crisis
    - HD may take a bit more time because of Europe
  - But peers are fully priced for the recovery
  - HD is still cheap
    - At EUR 42.5 per share
      - 1.1 EUR/USD
      - $47
    - 9.9x EV/2014 EBIT
      - About 13.2x after-tax earnings
    - 5.8x EV/2006 EBIT
      - 7.7x after-tax earnings
    - 3% dividend yield

Durability

Window Blinds and Shades Are Better Sold by Independent Dealers



Hunter Douglas delivers custom orders in 7 days or less

- The demand for Hunter Douglas (HD) products is durable
    - People switch from curtains to blinds and shades overtime
        - Curtains hold 95% market share in developing markets like India[1]
            - But hold only 50% in developed market
        - Example:
            - In the U.K.
                - Curtains hold 45% of the market
            - In the U.S.
                - Curtains hold 26% of the market
- There's no risk of Chinese imports
    - Asian imports are for stock products
        - Very low quality
            - Cheap materials
            - Cheap operating systems
        - Fixed styles and sizes
        - Available in mass merchandisers
            - Bed, Bath and Beyond
            - Target
            - Wal-Mart

            - Kmart
    - Blinds and shades are custom products
        - Windows come in various shape and size
            - Requires
                - Distinct types of shades, shutters, or blinds
                - Distinct size
                - Distinct operating systems
        - Being close to customer is important
        - Springs Window Fashions (SWF) is a good example
            - The second largest player
            - 3 main brands
                - Bali: the biggest brand in the big box channel
                - Graber: the second brand for independent dealers
                - Horizon: another brand for independent dealers
            - Stock products represent 30% of SWF revenue[2]
                - Made in Asia
            - Customer products represent 70% of SWF revenue
                - Parts are made in 3 factories in the U.S.
                - Assembling is done in 3 plants in Mexico
                - Deliver in 2 weeks[3]
        - U.S. competitors moved assembling activities to Mexico
            - Deliver in 2 weeks or more
                - Example:
                - Quan did a survey in Blinds.com for different brands
                    - Bali: deliver in 13-15 days
                    - Graber: deliver in 13-17 days
                    - Blinds.com: deliver in 10-16 days
                    - Levolor: over 30 days
        - Hunter Douglas delivers in 1 week
            - In North America[4]
                - Parts are made in 8 manufacturing facilities
                    - Based in the U.S.
                - Assembling is done in 3 plants
                    - Cumberland, Maryland
                    - Salt Lake City, Utah
                    - West Sacramento, California
            - In Europe[5]

            - Parts are made in 6 manufacturing units
                - Mainly in Netherlands
                - 10,000 different shapes and sizes
                    - Metal sheets
                    - Fixtures
                    - Textiles
                    - Paint used in the final finish
            - Assembling is done by
                - HD's 20 or so assembly plants around Europe
                - Or independent fabricators
        - This is economically possible
            - Parts production doesn't use much labor
                - Example:
                - SWF maintains parts production in the U.S.
            - Assembling requires more labor
                - HD invests in automation instead of offshoring
- There's little risk from big boxes
    - HD sells only through independent dealers
    - Big boxes have small market share
        - The price-sensitive segment has 25% market share[6]
            - In 2009
            - According to Jay Steinfeld
                - the CEO of Blinds.com
        - The price-sensitive segment might have grown during the crisis
        - But that's not necessarily true
            - SWF has the biggest brand in big boxes
                - Bali
            - SWF also sells Graber to big boxes
            - SWF is in a good position if the price-sensitive segment grew
            - SWF didn't outperform HD over the 2006-2013 period
            - SWF revenue was
                - (according to Moody)
                - 2006: $563 million
                    - For 12 months ended March 31, 2007
                - 2012: $531 million
                    - For 12 months ended December 29, 2012

            - HD revenue in North America was
                - 2006: $1,210 million
                - 2013: $1,099 million
    - Big boxes have low market share because[7]
        - Blinds and shades require service
            - Measurement
            - Installation
            - Fashion advice
                - Color
                - Pleat size/slat size
                - Material and texture
                - Fabrics
                - Type of products
                    - Shades/blinds/shutters
                    - Lifting system
                    - Etc.
        - 80% of window treatment shoppers are women
            - Design/look is important
        - Big boxes are good at selling basic product
        - But not products that requires services
            - Big boxes have poor services
                - Don’t have a lot of staffs
                    - Example
                    - A customer had to go to Home Depot 2-3 times for a long time
                        - Giving measurements
                        - Pricing out how much it would cost
                        - When it would be installed
                        - How it could be done
                    - There was a lot of troubles
                        - And confusion where they got something wrong
                - Hit-or-miss experience with contracted installers
                - Difficult to get warranty services
                    - Customers have to deal with manufacturers
                    - (Dealers will take care if they buy from dealers)

        - Most online advices suggest not use big boxes
    - Most HD dealers don't see big boxes as competitors
        - Big box customers[8]
            - Price conscious
            - Just want something functional
            - Young people
            - Do-it-yourself people
            - Don't want to make long-term investment
                - Like renters
        - HD has a different customer profile
            - HD exploits cable TV to target[9]
                - 35 to 64-year-old college educated woman
                    - Fashion conscious
                    - Upscale
                    - Has a strong interest in home decorating
                - Average household income of $75,000
        - 34-65 year-old consumers account for 60% market share
            - Under 25: 9%
            - 25-33: 19%
            - 34-65: **60%**
            - Over 65: 12%
- Big boxes may gain market share if they have better services
    - But they have two problems
    - They may not be as focused
        - Have to change the way they do business
            - Have more knowledgeable staffs
        - But the opportunity is small
            - Doesn't move the needle
            - The market is about $4 billion
                - (According to Blinds.com CEO Jay Stenfeld)
            - If Home Depot gets 50% market share
                - $2 billion
                - => Less than 2.5% growth
    - Product quality usually decline when sold through big boxes
        - Reduce costs by using low quality materials, etc.
- The biggest change is online retailers of window blinds
    - Disadvantages

            - Can't see color
            - Can't feel texture
            - May measure incorrectly
            - Difficult to get repair/warranty services
    - Online retailers serves the price-sensitive segment
        - Compete with big boxes
- Budget Blinds is an interesting franchise of shop-at-home dealers
    - Upfront investments: $89,240 - $187,070
        - Initial franchise fees
        - Van
        - Equipment
        - Etc.
    - Franchisees pay monthly fees
        - $2,000 monthly after 2 years
    - Benefits for franchisees
        - 2-week training
            - (have to pay their own travel expenses)
        - Get their own territory
        - Get sales leads from Budget Blinds
        - Can get blinds and shades from Budget Blinds' alliance list
            - Budget Blinds negotiates with suppliers
            - Hunter Douglas isn't in the alliance list
                - Hunter Douglas doesn't sell to online retailers
    - Budget Blinds is a loosely controlled franchise
        - Franchisees have freedom to set their own price
            - Negotiate with customers
        - Franchisees can sell brands off the alliance list
            - Many Budget Blinds franchisees sell Hunter Douglas
        - There's no minimum purchase requirement from Budget Blinds
- HD won't necessarily lose market share if independent dealers lose market share to big boxes or online competitors
    - HD has the best competitive position in this channel (see Moat section)
    - HD is devoted to this channel[10]
        - Don't sell to online retailers
        - Don't sell to big box
    - Other brands sell to online and big boxes
        - Quality usually decline

            - Some dealers said Levolor and Graber are cutting down on their quality
                - To be in the big box stores
        - Other brands are the first to alienate themselves with dealers
    - As long as HD offers a wide range of pricing
        - Can have 40-50% market share like Sherwin-Williams
- HD is more durable than Benjamin Moore
    - Both sell through independent dealers
    - HD has stronger competitive position
        - Sherwin-Williams is bigger than Benjamin Moore
            - Sell through their own stores
    - Both paint and blinds are complicated products
        - People are loyal to paint manufacturers
            - Save their old paint cans
                - To keep track of exactly what paint they use
            - Save the code of the products
    - But paint is still a Do-it-yourself product
        - Home Centers owns 61% of market share for DIY paint
            - Paint stores have only 15% market share
            - (according to Sherwin-Williams May 2012 Presentation)
    - Blinds and shades require
        - Measurement
        - Aesthetic advices
        - Installation
    - Blinds are decors
        - Just part of a whole process
    - => it's more difficult for big boxes to gain share in blinds and shades than in paint
- Benjamin Moore grew 1.8% from 1999 to 2013
    - 1999: $780 million
    - 2013: $1 billion
    - Paint stores lost market share for DIY paint[11]
        - 25% in 2003
        - 16% in 2013

[1] "Hunter Douglas, a Dutch company that introduced venetian blinds to this world over 90 years ago, is aggressively positioning itself **in the Indian market where**

curtains still command a 95 per cent market share compared with 50 per cent in the developed markets." – _Hunter Douglas Offers to Dress Up Your Windows_, D Govardan, mydigitalfc.com, 23 September 2009

[2] "**About 70 percent of company revenues come from its custom products, marketing director Tom Rodgers said, with the other 30 percent from sales of stock window treatments and drapery hardware, basic and decorative.**

Factories in Asia produce the company's stock blinds and shades and the hardware, which come in fixed styles and sizes. The hardware is sold in specialty stores such as Bed, Bath and Beyond, while mass merchants such as Target, Wal-Mart and Kmart carry the stock products.

Custom products, in contrast, are made to customer specifications, so it's impossible to say how many distinct models or types of shades, shutters or blinds are offered, company officials said.

"It's infinite," Fawcett said. "It's an eighth of an inch this way, an eighth of an inch that way. You pick the color, you give the dimensions, you say you need the cord on this side or that side. The bottom could go up, the top could come down. There are lots of different options."

The company's U.S. properties include three factories where parts for the custom products are made; two distribution centers for stock products in Ohio and Nevada; and a customer service center where orders are processed in Williamsport, Pa.

The company's three plants in Mexico assemble most of the custom products and employ about 70 percent of the company's roughly 4,600 workers." – _Sunny Outlook for Middleton Shade Maker Springs Window Fashions_, Karen Rivedal, Wisconsin State Journal, 11 September 2010

[3] "**Now more than 96 percent of company products are delivered to customers' homes within 14 days of the order**, Fawcett said, with fewer documented errors in color or sizes." – _Sunny Outlook for Middleton Shade Maker Springs Window Fashions_, Karen Rivedal, Wisconsin State Journal, 11 September 2010

[4] "Hunter Douglas, the leading manufacturer and marketer of custom window fashions in North America, will be phasing out of all remaining two-step distribution relationships with independent, third-party fabricators and will fully

transition to direct, one-step distribution through its Hunter Douglas Fabrication Division. This transition will take place gradually over the next 12 months and is expected to be completed in the third quarter of 2014. In the interim, the independent, third-party fabricators will continue to be fully operational and will supply and support their customers as they always have.

The Hunter Douglas Fabrication Division, which, at present, directly supports and services most of the Hunter Douglas brand business, **operates out of three large custom fabrication facilities located in Cumberland, Md.; Salt Lake City, Utah; and West Sacramento, Calif.**, as well as **five customer service centers and 11 dealer training and service centers**. The division is supported by **eight Hunter Douglas brand manufacturing and R&D facilities, all based in the U.S.**" – Hunter Douglas Moves to Fully Integrated Business Model, Hotel Management, 01 October 2013

[5] "The job of matching the production of parts with what the consumer wants adds up to a massive exercise in logistics. **Every day, 10 to 15 trucks arrive at the company's central European warehouse near Rotterdam with parts from the company's six main European manufacturing units. These are mainly in the Netherlands, and produce items such as metal sheets, fixtures, textiles - and even the paint used in the final finish.**

"We believe our competitive advantage is helped through our decision to make these products ourselves rather than leave the job to outsiders," says Michiel Tonino, European operations director.

The individual components - made in some 10,000 different shapes and sizes - spend as little time as possible in the warehouse before being reshipped either to Hunter's 20 or so assembly plants around Europe or to other companies which can, under some circumstances, take over the assembly and distribution job under a licensing deal." – Output and Demand Need Careful Cohesion, Peter Marsh, Financial Times, 25 October 2000

[6] "SM: How big is the window blinds market?

Jay Steinfeld, Blinds.com CEO: **About $4 billion. We have plenty of room to grow. We believe that Home Depot and Lowes are our competition. That is where the price-sensitive market goes to shop. We believe that market is about $1 billion and that our market is at least $1 billion**. It used to be that 75% of the market was Sears, Montgomery Wards, and JC Penney's. Sears and Montgomery Wards got out of it, but mom-and-pops came into it. **Home Depot**

and Lowes came in and started supplanting the mom-and-pop stores. Manufacturers still see mom-and-pop stores as their core constituency. But mom-and-pops just cannot compete in the 'do-it-yourself' market. The economy, however, is turning people into do-it-yourself consumers." – Blinds.com CEO Jay Steinfeld Interview, One Million by One Million blog, 04 November 2009

[7] We asked Hunter Douglas's dealers why big boxes don't have a big market share.

One dealer in **Texas** said that sometimes **a lot of the shades are custom and they have a guy to go measure it themselves**. **There are windows of all sizes and a lot of the time the customer can't measure it right** and they make a mistake on their purchase. Also she thinks **the quality and the warranty matters a lot in this category** so that could be another reason.

One dealer in **Washington** said that's because **window coverings are custom a lot of the time and it's a long term investment where service, warranty and quality really matters**. They have people bringing blinds and shades from 20 years ago for servicing. It has a big impact on your home and people usually keep them for up to 20 years. Longer than a car, so the warranty is a big deal since this is like a long term investment for people.

One dealer in **Vermont** said that **there's a certain amount of fashion in selling the product. This isn't a commodity type of product and he offers fashion advice to a lot of their female shoppers**.

One dealer in **Washington** said that **there are lots of details in blinds. To understand them takes a lot of work. There are so many details with even every specific type of blinds**. Unless a specialist understands each type of blinds and what the customer specifically needs, you're not going to get the best service. **Purchasing blinds is probably a more sophisticated process than the other categories**.

One dealer in **Minnesota** said that big box stores **just don't give the level of service which is really important in the window treatment category. The purchase requires a higher level of knowledge and service than what a lot of the big boxes can provide**.

One dealer in **Connecticut** said that **the employees at big box stores are not trained well. She comes to the business from a design perspective**. Home

Depot will shove someone there. **Blind isn't just a blind, it's a décor. A blind is just a part of the whole process.** The level of service is probably more important because it's a long term investment. **People see the blinds at other people's places and they see a huge difference between what good quality is and what poor quality is**.

We also asked a **VP of Sales at Springs Window Fashions** and he said "**This is an "influencer" assisted sale in most cases. There is a high risk of making an error because it is a custom made product, therefore, with limited staffing and high turnover the big box stores have struggled to take a larger share**. However, Depot and Lowe's are both starting to focus more on the DIFM customer through their shop-at-home (SAH) programs. JCP has always had an in-home Custom Decorating program but it is a relatively new thing for the HICs.

Therefore, there is a chance they could take more share from the traditional designer channel in the future. They are also doing more to sell online, hence Depot's purchase of blinds.com. **I do see growth happening in both HIC and Designer channels because some customers prefer the high-end experience, especially older women/couples with more disposable income. But others how are more price-conscious will seek out alternatives like Depot and Lowe's.** Budget Blinds is also in a strong position because they have designers but at a value. "

[8] One Hunter Douglas dealer in **Arizona** said that they don't consider big box stores as competitors. **Home Depot actually keeps business cards for their dealership and refers business to them for some of the supplies that Home Depot doesn't have**. They do the same. **If a customer just wants some blinds for a rental home, they'll refer them to Home Depot**.

One Hunter Douglas dealer in **Vermont** said that **big box stores in some ways attract younger people who aren't as sophisticated. They are more price-conscious but once they're a bit more educated on this product, and they've experienced the poor service quality of the big boxes, he feels that the younger people will eventually lean towards Hunter Douglas**.

One Hunter Douglas dealer in **Washington** said that **people who go to big box stores are do-it-yourself type and hoping they save dollars**. People who come to a showroom are looking for specific type of blind. They have some specific issues. She thinks online option can be competition for her business. **If you're not picky or just want something for a rental property, you'll go to big box. People who come to the dealers usually have something more specific they want and they go for the service and quality.**

One Hunter Douglas dealer in **Minnesota** said that people who go to Hunter Douglas want a quality product and the warranty. **They get lots of help to make their decision which isn't offered at Home Depot or online. Of course, people who are price conscious may use the other alternatives but Hunter Douglas is for those who want quality and a high level of service**. **They don't see online as viable competition because customers can't see colors, feel the texture, etc.**

[9] "With the growth of cable television lately - and the cable networks in particular - the commercials allow us to target particular channels as well as a particular audience," Marv Hopkins, president/CEO, Hunter Douglas, Inc. told Home Textiles Today. "The commercials allow us to target particular audiences in a nationwide campaign."

PRECISE DEMOGRAPHICS

According to Hopkins, the three commercials currently running focus primarily on the 35- to 64-year-old college educated woman with an average household income of $75,000. She is fashion conscious, upscale and has a strong interest in home decorating." – Hunter Douglas Ads Follow the Beat of a Different Drummer, Marvin Lazaro, Home Textiles Today, 04 September 2000

[10] "**Paint and Decorating**: How do independent retailers figure into your day-to-day work at Hunter Douglas?

Joe Jankoski [Hunter Douglas's VP of merchandising]: **We believe that our products are most effectively sold by retailers who have the [required knowledge and value-added services]**. We've determined that the independent specialty retail channel is the channel that does the best job. For example, **we've taken the Hunter Douglas brand and [stopped selling it] on the Internet. And our products are not sold on the retail floors of home centers and department stores anymore.**

Pant and Decorating: So many marketing strategies today center around the

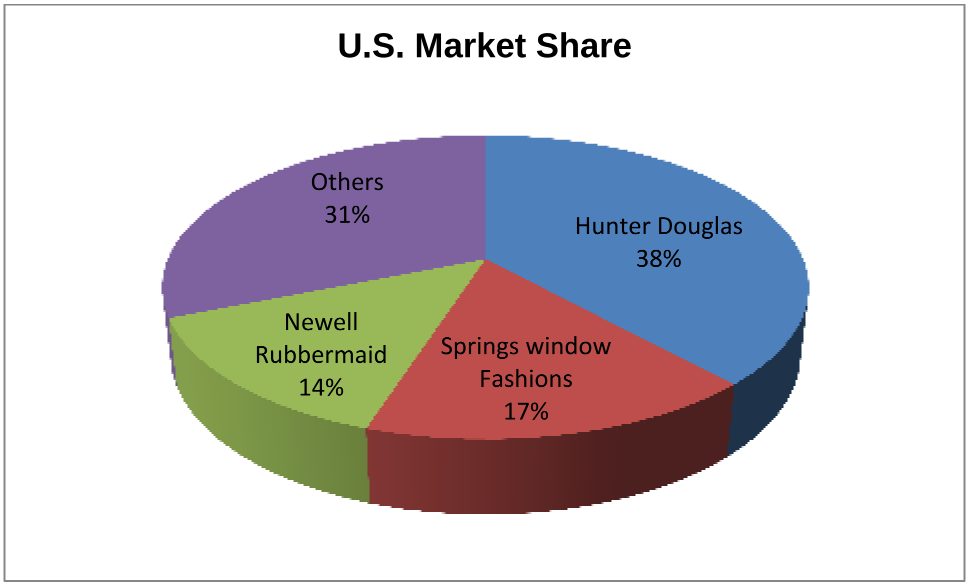
Internet's economy of scale. The decision to drop the web as a sales tool must have been a tough one.

Joe Jankoski [Hunter Douglas's VP of merchandising]: It was a very big decision. Almost counterintuitive to what certain people think. **But in June of 2010, we made that decision. Keep in mind that Hunter Douglas sells only custom-ordered products, and it's more difficult to sell a custom-ordered product online than it is to sell an SKU. [Our products] have multiple size options, and each size option has hundreds of colors. Plus, there are control options that are wide and varied and sometimes dependent on the size you order**. So it's a complex purchasing decision, and we just didn't feel comfortable putting that totally in the hands of the consumer, who probably doesn't know a lot about it." – *Interview with Joe Jankoski*, Paint and Decorating, March 2014

[11] "Abrams thought Moore was hemmed in by its distribution approach. The chains were selling ever more paint. (**According to an analyst at research firm Orr & Boss, independent dealers now sell 16% of all house paint, down from 25% in 2003.**) The CEO, says a person familiar with his thinking, believed selling through big boxes could introduce Moore paint to new customers; once impressed by the brand's quality, he believed, they would buy directly from Moore stores. (Contacted by Fortune, Abrams says he is contractually barred from speaking to the press.)" – *The Wrath of Warren Buffett: How Benjamin Moore Almost Broke His Promise*, Colleen Leahy, Fortune.com, 17 September 2014

Moat

Hunter Douglas Is the Best Brand for Independent Dealers



Hunter Douglas has about 38% market share in the U.S.

- Market share
    - Globally
        - 5 times bigger than the second biggest competitor
    - In the U.S.
        - Market share in 2010
            - (According to IBIS World)
            - Hunter Douglas (HD): 38.2%
            - Springs Window Fashions (SWF): 16.8%
                - SWF has 3 brands
                - Bali: the biggest brand in the big box channel
                - Graber: the second brand for independent dealers
                - Horizon: another brand for independent dealers
            - Newell Rubbermaid: 13.9%
                - Newell has 2 brands
                - Levolor: a big brand in the big box channel
                - Kirsch: a brand for independent dealers
        - HD brand might be 3-4 times bigger than the second biggest brand
            - HD is more than 2 times bigger than SWF

        - Only 70% of SWF's revenue are custom made
        - SWF has 3 brands
      - One industry insider said 4 companies hold 90% market share
        - Hunter Douglas
        - SWF
        - Nien made
        - Newell
    - HD may have a stronger competitive position in Europe
      - Revenue (for window coverings)
        - North America: $1,019 million
        - Europe: $916 million
      - SWF is the second largest global competitor
        - But does all business in North America
      - => European competitors are weaker
- HD has an integrated production
    - Make 80% of components in-house[1]
    - HD has smelting plants[2]
      - Make flexible alloy for the blinds
      - Taking 70% of raw materials from recycled aluminum products
      - Operates a trading exchange
        - Buy and sells aluminum alloys and bauxite
        - Metal trading business makes about $15 million EBIT
    - In Europe
      - Parts are made in 6 manufacturing units
        - Mainly in Netherlands
        - 10,000 different shapes and sizes
          - Metal sheets
          - Fixtures
          - Textiles
          - Paint used in the final finish
      - Assembling is done by
        - HD's 20 or so assembly plants around Europe
        - Or independent fabricators
    - In North America[3]
      - Parts are made in 8 manufacturing facilities
        - Based in the U.S.

        - Assembling is done in 3 plants
            - Cumberland, Maryland
            - Salt Lake City, Utah
            - West Sacramento, California
- Integrated production leads to 2 advantages
    - Low cost
        - Economies of scale
            - Evidence:
            - Sales/Average PPE is just 4.6
                - A lot of investment in PPE
                - => Volume is important
            - HD concentrates production of components in a few plants
            - SWF doesn't move parts production outside the U.S.
            - HD sells components to independent blindmakers
                - In Europe
        - HD may have the lowest cost
            - Has the highest volume
                - Lowest production cost
            - HD products should have the lowest cost for similar service
                - Dealers may want the same profit per order
                    - No matter what brand they sell
        - HD's premium price obscures HD's cost advantage
            - Some said 20-50% more expensive than some brands
            - Some said the price difference between HD and other brands isn't huge
                - But products are of much higher quality[4]
                - Offer lifetime warranty
            - HD is cheaper if amortized over the lifetime of the products
    - Proprietary products
        - HD spends **$35 million** on R&D annually
            - There are 100 R&D employees in the U.S.
            - $35 million = **6-7%** of SWF's revenue
                - Only **1.3%** of HD's revenue
                - **5%** gap
                    - May eat up all SWF's EBIT margin
        - Translucent sheer fabrics

        - Used in shades
    - Operating systems[5]
        - LiteRise
            - Raises and lowers window fashions with a gentle touch on the bottom rail
        - UltraGlide
            - A single, retractable cord that maintains a constant length
                - Whether the shade is raised or lowered
    - Processes for bonding diverse fabrics[6]
        - To yield products like
            - Silhouette
            - Pirouette
            - Vignette
            - Luminette
    - People may argue that it's not worth paying more for HD basic products like horizontal blinds
        - But everyone agrees
            - Nothing is comparable to Silhouette
                - Copycats can be cheaper[7]
                    - But would fray in a few years
                - Levolor or Graber don't offer products like Silhouette
                - No other manufacturers make products like Luminette[8] [9]
                    - (similar to Silhouette)
            - Great sheer fabrics[10]
            - Unique operating systems
- The biggest advantage is the brand
    - HD advertises a lot
        - Cable TV
        - Magazines
        - Radio
        - Online
            - Yelp
            - Google
            - email

                - Etc.
                - Selling and marketing expenses is 20% of sales
                    - $537 million last year
                - Dealers say other brands rarely advertise
                    - Except for blinds.com stepped up advertising recently
                        - (an online retailer)
                    - It's easier for them to sell Hunter Douglas[11]
        - Words of mouth
            - HD is the most popular brand
                - People see the products at other people home
                - And learn about HD
            - One dealer said 80% of customer is from words of mouth
            - HD says words of mouth is the most effective way to increase sales[12] [13]
- The brand strength is the main reason for dealers to sell HD products
    - HD brings traffic to dealers
        - Customers already know about HD
        - Dealers don't have to educate them
    - Without HD, dealers can't compete with big boxes for traffic
        - People don't know where to buy blinds
            - Infrequent purchase
    - Many dealers switched to selling HD exclusively overtime[14]
        - It's easier to sell HD products
        - Less customer dissatisfaction
        - Other brands cheapen quality to sell to big boxes
            - Some dealers only carry other brands to offer low-end products
        - Other brands don't give the same level of support
- HD widens its moat by giving more support to dealers
    - Provides dealers with
        - Pre-designed websites
        - An Internet Customer Management program (iCM)
            - Custom-built software that helps dealers keep track of
                - Customer information
                - Projects
                - Appointments
                - Etc.

        - Dealers can link iCM database with Constant Contact
            - A tool to send e-newsletters
            - Dealers can also design their own e-newsletter or flyers
                - Put in their own content
                - Add local stories
            - But still maintain a look that reflect the HD image
                - Use HD's headers and logo
    - HD has a very nice website to help purchase process
        - Work for computer or tablets
        - Customers can
            - Make different selections
                - Products
                - Colors
                - Lifting system
                - Etc.
            - See immediately the picture of the product
                - After each selection
            - Upload their own picture
                - And see how it'll look after installing the products
        - The website routes traffic to dealers
            - Through the dealer locator
    - Offer a wide range of pricing/products[15]
        - There's almost something for everybody
        - Have metal blinds for the low end stuff
        - Some products in the Duette catalogue comparable to what Home Depot has to offer
        - Have something comparable to Levolor and Graber
            - (on the low end)
        - => Allow dealers match any customer budget
- Hunter Doulas is a traffic aggregator for dealers
    - Big box or online competitors are traffic aggregators for brands
    - Hunter Douglas can maintain dominant market share
        - If they have products in a wide range of pricing

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[1] "Against the fashion in much of industry for outsourcing, the company has a highly-integrated approach to manufacturing. **In Europe, it makes in its own plants roughly 80 per cent of the individual components** that go into the

product that the consumer buys and which are sold under brand names such as Duette and Luxaflex.

The job of matching the production of parts with what the consumer wants adds up to a massive exercise in logistics. **Every day, 10 to 15 trucks arrive at the company's central European warehouse near Rotterdam with parts from the company's six main European manufacturing units. These are mainly in the Netherlands, and produce items such as metal sheets, fixtures, textiles - and even the paint used in the final finish.**

"We believe our competitive advantage is helped through our decision to make these products ourselves rather than leave the job to outsiders," says Michiel Tonino, European operations director.

The individual components - made in some 10,000 different shapes and sizes - spend as little time as possible in the warehouse before being reshipped either to Hunter's 20 or so assembly plants around Europe or to other companies which can, under some circumstances, take over the assembly and distribution job under a licensing deal." – Output and Demand Need Careful Cohesion, Peter Marsh, Financial Times, 25 October 2000

[2] "It was founded 50 years ago by a returning émigré who had fled to the US during the Second World War and teamed up with a fellow entrepreneur. Between them, they invented and marketed a flexible alloy that could be used to make window blinds. The enterprise flourished and Hunter Douglas is now a large, complex organisation, made up of 145 companies with 62 manufacturing and 83 assembly plants employing 15,000 people, and a supply chain to match.

The firm's operations include smelting plants that make the flexible alloy for the blinds. It's also a good global citizen, taking 70 per cent of raw materials from recycled aluminum products. In addition, Hunter Douglas operates a trading exchange where it buys and sells aluminum alloys and bauxite, the clay from which aluminum originates.

Its global operations are broken down into sites that trade, smelt, coat and produce the raw material, which is then supplied to other sites that manufacture the components. These are transferred to the assembly plants where the blinds are made up before being distributed and sold to business customers and through retail chains such as John Lewis in the UK." – *Blinds Ambition*, Helen Riley, Supply Management, 19 July 2001

[3] "Hunter Douglas, the leading manufacturer and marketer of custom window fashions in North America, will be phasing out of all remaining two-step distribution relationships with independent, third-party fabricators and will fully transition to direct, one-step distribution through its Hunter Douglas Fabrication Division. This transition will take place gradually over the next 12 months and is expected to be completed in the third quarter of 2014. In the interim, the independent, third-party fabricators will continue to be fully operational and will supply and support their customers as they always have.

The Hunter Douglas Fabrication Division, which, at present, directly supports and services most of the Hunter Douglas brand business, **operates out of three large custom fabrication facilities located in Cumberland, Md.; Salt Lake City, Utah; and West Sacramento, Calif.**, as well as **five customer service centers and 11 dealer training and service centers**. The division is supported by **eight Hunter Douglas brand manufacturing and R&D facilities, all based in the U.S.**" – *Hunter Douglas Moves to Fully Integrated Business Model*, Hotel Management, 01 October 2013

[4] One Hunter Douglas dealer in **Nebraska** said that **if one looked at a Levolor, Graber and HD side by side, one would undoubtedly choose HD. It's just a much better product with more innovation and quality**.

One dealer in **Minnesota** said that they usually get whatever brand they think their customers will need. **Their attitude towards other brands like Levolor and Graber is that they can't offer what Hunter Douglas has to in terms of service, and premium quality. So they really can't replace their Hunter Douglas at all**.

One dealer in **New Jersey** described **a product by Hunter Douglas that had some extra features making it a better product than Levolor or Graber comparisons but it was at a very similar price point to them.**

Someone said on the Internet that Graber is only $200 less than Hunter Douglas, but Hunter Douglas is much better:

"I actually had a client the other day who was **comparing the Costco Graber vs Hunter Douglas for wood blinds and shutters** (they used to be my Costco HD client) and the **Graber price was only about $200 less than HD, which is strange because HD is such a better product.**

You might want to go to Lowe's if you want to stay with Graber. I know they also have finance deals and I believe their installation is much less expensive than what they charge through Costco. Hope this helps."

[5] "**We expanded the availability of our proprietary LiteRise® and UltraGlide® lifting systems across more of our product lines and continued to increase the percentage of products purchased with one of these distinctive systems which differentiate our product collections from competitors and offer superior benefits to consumers.**" – Hunter Douglas 2014 Annual Report

[6] "Our proprietary innovations include **the energy-efficient cells used in Duette® and Vignette® Architella® Shades; translucent sheer fabrics used in shades, sheers and shading systems; and the process for bonding diverse fabrics** to yield products like Silhouette® and Pirouette® Window Shadings, Vignette® Modern Roman Shades and Luminette® Privacy Sheers." – Hunter Douglas 2014 Annual Report

[7] One Hunter Douglas dealer in **Michigan** said that **there have been others who have copied their products [silhouette]** and they have even sold them [copycats] before but decided not to. **The other product, although cheaper would fray in a few years whereas HD would be good for much longer. So they decided not to sell the other inferior products anymore** because their sales, although for a similar product at a cheaper price point, were not as good.

[8] Someone said on the Internet: "**We ultimately went with Hunter Douglas because we had settled on the Pirouettes and Luminette and no other manufacturer made a comparable product (the two other Luminette 'products' we looked at were not as nice IMO as the HD Luminette).**"

[9] Someone said on the internet:

"**I would avoid the "cut in store" blinds as they tend to have very cheap internal mechanisms** (you get what you pay for in that regard). When you go the "custom" route, **it truly comes down to which look you like the best, brand has very little to do with it overall**. However, in specific categories (real wood, roman shades, etc), brands tend to outshine others.

(1) Real Wood: Bali, Levolor, HD are all good here
(2) Roman: Bali and HD have nice selection.
(3) Natural: Bali, HD, and Levolor good here
(4) Cellular: Levolor tends to lead the pack here due to superior fabrics and price point, but Bali does good in this category to.
(5) Silhouettes: **HD's proprietary product. GORGEOUS, but expensive. You always tend to see this on this home remodel shows on DIY network...**"

[10] Someone said on **Reddit.com** "**I work for a window treatments manufacturer**. I won't say which one, but they have not been mentioned in this thread. Not to say that our products have not been linked to. They have. **We manufacture a huge number of private label products for big box stores, department stores, and internet retailers.**

Personally, I don't think Hunter Douglas is worth it at all unless you like the look of their fabrics or one of their handfuls of unique control mechanisms. **Or if you like the Silhouette, which is one of the truly unique offerings in window treatments, which I think looks really good** (even though they're our competitor and that particular product is insanely expensive. **I will say with no shame that were I wealthy I would put them in my home.**)"

[11] One Hunter Douglas dealer in **New Jersey** said that **nobody else does the same kind of advertising as HD does so it seems a lot easier to sell HD since people get them and it's a good experience for them and they tell their friends about it.**

[12] "**Paint and Decorating**: What are some things contemporary retailers need to do to stay successful?

Joe Jankoski [Hunter Douglas's VP of merchandising]: For one thing, they must have an efficient digital database that is current, active and emailable versus a list of old customers on paper. **Clearly, the best way to a new customer is through an old customer, so retailers must continually stay in touch [and make those old customers] their local brand's spokespeople, who provide word of mouth to their circle of friends and family.**" – *Interview with Joe Jankoski*, Paint and Decorating, March 2014

[13] "**Satisfied customers purchase more products and better products, become long-term repeat clients and provide referrals of friends and family. This is the most cost-effective way to increase sales.**" – Hunter Douglas Showcase Program Brochure

[14] One dealer in **Michigan** said **they used to sell other brands but they sold more Hunter Douglas so they became a Gallery Dealer and then Centurion dealer (selling only Hunter Douglas products)**

One dealer in **Nebraska** said they sold most brands in the past. Hunter Douglas ended up being the most innovative. **Most selection, best quality. Better experience for him. Less issues and less cosumer dissatisfaction**. **Now they only sell HD because it gives customers a better time and it just ended**

up being this way because they sold more and more HD. He enjoys selling quality more, knowing that the customers will have less problems in the future and they'll be glad for the quality. He thinks he can probably make more money if he tried selling everything but it wouldn't be as enjoyable a job and probably not worth the effort to just make the money.

One dealer in **Vermont** said that **a lot of brands cheapened their quality to sell to the Box stores**. Box stores pressures them to cut down on the quality so he feels a lot of the brands have deteriorated in terms of the material quality. **They do sell some of the other brands. 75% of their sales are Hunter Douglas. The other brands are just for the lower price points for people who may have a rental property or just don't care very much about the long term**.

One dealer in **Washington** said that **they sold other brands but moved to exclusively HD because they don't feel other brands offers the same level of support as HD does.**

[15] One dealer in **New Jersey** said that **customers aren't necessarily affluent. Hunter Douglas has such a wide variety of products that there is almost something for everybody**. If somebody wanted a product for their baby room and they thought it was too expensive, they could keep moving down a list of products until something within their price point was found.

One dealer in **Arizona** said that customers aren't even necessarily very affluent people. She said she gets **a lot of people in the middle class to the higher end of it**. **Hunter Douglas has a wide range of pricing now. In their Honeycomb catalogue, she said that there are some products that are really comparable to what Home Depot has to offer**. Because they have such a wide range of selection for everybody, it is not necessarily a lot more expensive than competitors especially for the quality and brand you get along with it.

One dealer in **Washington** said that Hunter Douglas has a very wide range of pricing and product types. They offer something called silhouette which not even Levolor or Graber offers. It really depends on the size of the window though in terms of pricing. **They have something comparable to Levolor and Graber on the lower end and they have certain things that Levolor and Graber doesn't have on the higher end**.

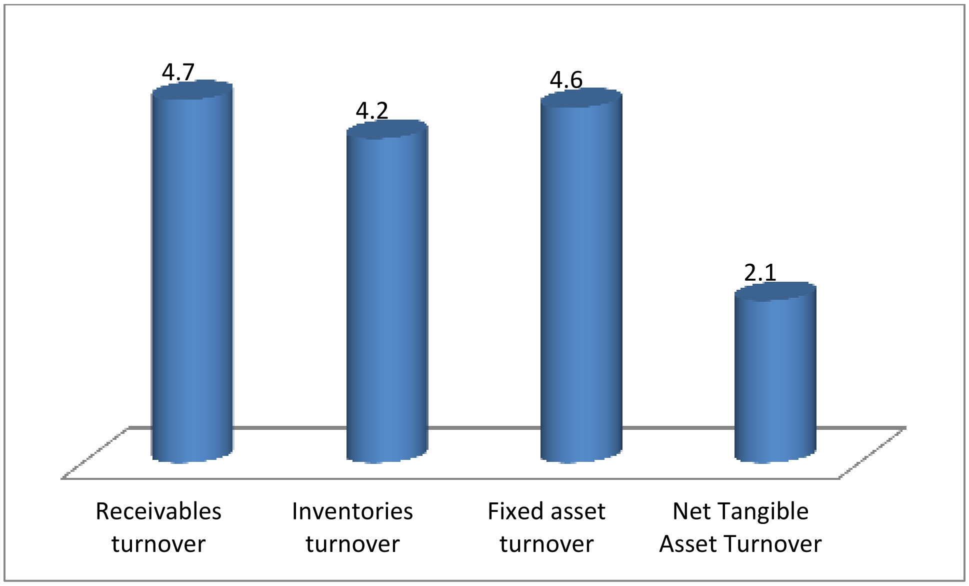
One dealer in **Vermont** said that **Hunter Douglas is more and more able to provide products for the full spectrum. They have high end and lower end**

that competes very well with Levolor and Graber. He feels Levolor and Graber are cutting down on their quality to be in the big box stores.

One dealer in **Washington** said that **Hunter Douglas has the high end stuff of course and then they have metal blinds for the lower end stuff**. **They don't display it but it's there if the customer wants it**. HD has a very wide range of pricing for products they offer.

Quality

Cyclicality and Low Turnover Make Hunter Douglas less than a Great Business



Hunter Douglas turns net tangible asset just over 2 times

- The business has long cycle
  - Revenue mix was[1]
    - During housing boom year
      - New homes: 50%
      - Renovation: 50%
    - During crisis
      - New homes: 1/3
      - Renovation: 2/3
  - There were spurts of growth
    - 1998-2000: **6.6%** annual growth
      - 1998: $1,381 million
      - 2000: $1,570 million
    - 2000-2002: 0% annual growth
      - 2000: $1,570 million
      - 2002: $1,590 million
    - 2002-2007: **14%** annual growth
      - 2002: $1,590 million
      - 2007: $3,028 million

        - 2007-2009: 11% annual **decline**
            - 2007: $3,028 million
            - 2009: $2,376 million
        - 2009-2014: 2.5% annual growth
            - 2009: $2,376 million
            - 2014: $2,695 million
    - Revenue declined 22% between 2007 and 2009
        - Gross margin declined by 4%
            - 2007: 41%
            - 2009: 37%
            - This is due to manufacturing deleverage
            - Same trend in housing product companies like Mohawk
                - 2007 gross margin: 28%
                - 2009 gross margin: 23%
    - HD has never lost money
        - EBIT Margin in normal years are high enough
            - 10-14%
        - Declined to 5% in 2009
- HD has a two-tier distribution model
    - HD supplies components to fabricators
        - Several **thousands** of independent fabricators worldwide
        - 75 company-owned fabricators
        - Fabricators assemble and sell the products
            - Fabricators nominate dealers
            - HD review and select dealers
    - Dealers
        - Over 100,000 dealers around the world
        - Mom-and-pop operations
        - Don't have to hold inventories
            - Only need a show room
        - Help customers choose a product
        - Send orders to fabricators
        - Wait for **5-7 days**
            - And install the products
        - Shades offer the highest gross margin
            - Many dealers can sell at list price
                - Get **40%** gross margin or more

            - Home Depot gross margin: **34%**
            - Lowe's gross margin: **34%**
        - Customers can get quotes from several HD dealers
            - And negotiate
            - To get the best price
- HD acquires and consolidate fabricators overtime
- HD has a 1-step distribution model in the U.S.
    - All assembling is done by 3 plants
        - Cumberland, Maryland
        - Salt Lake City, Utah
        - West Sacramento, California
    - HD works directly with dealers
        - 5,398 dealers in the U.S.
        - 1,056 dealers in Canada
        - Average about $160,000 sales to each dealer
            - If dealers make 40% gross margin
            - They can make **$120,000** gross profit per dealer
    - This model is better
        - More efficient
        - More consistent marketing
        - Closer to dealers
    - Inventories turnover didn't decline
        - Currently is 4.2
            - At historical average
    - This model would help reduce receivables
        - Sales/receivables is now 5.18
        - Fabricators usually take one month to collect receivables[2]
            - (from dealers)
            - Or 12x sales/receivables
- HD makes good ROIC
    - Sales/Average NTA is about 2.1
        - Huge investment in working capital
            - Sales/inventories is 4.2
                - Cost of Goods Sold/Inventories is 2.5
                - Or almost 5 months of inventories
                - This is due to the made-to-order model
            - Sales/receivables is about 4.7

            - Sells to independent fabricators outside the U.S.
            - Takes almost 80 days to collect receivables
    - Sales/Average NTA should improve overtime
        - Currently is 2.5
        - As HD switches to 1-step distribution
            - Improves sales/receivables
            - Without reducing sales/inventories
- EBIT margin is about 12%
    - From 1996 to 2007
        - Min: 10%
        - Max: 14%
        - Median: 13%
        - Mean: 12%
        - Standard deviation: 1%
        - Variation: 0.11 (very stable)
    - From 2008 to 2014
        - 2009: 5%
        - 2010: 6%
        - Other years: 7%
        - Lower EBIT margin can be explained by
            - Selling and marketing expenses/Revenue increased
                - 16-17% in 1996-2007
                - 20% currently
            - Slightly lower gross margin
                - About 40% in 1996-2007
                - 41% in 2007
                - 37% in 2008
                - 39% in 2014
                - Declined due to manufacturing deleverage
- ROIC is about 26%
    - About 26% in 1996-2007
    - About 14% in 2008-2014
        - Currently 18%
            - Thanks to improved Sales/NTA
            - This should continue thanks to the transition to the 1-step distribution model

- HD can reinvest more than competitors

- HD has lower cost than competitors
  - Thanks to economies of scale
  - Globally, HD is 5 times bigger than the next competitor
  - In North America, HD is 2 times bigger than the next competitor
  - Production of components are concentrated
    - And automated
      - Evidence: Springs Window Fashions (SWF) keeps parts production the U.S.
    - Volume is important
      - Example:
      - Between 2007 and 2009
        - Revenue declined 22%
        - Gross margin declined from 41% to 37%
  - HD spends $35 million on R&D annually
    - There are 100 R&D employees in the U.S.
    - $35 million = **6-7%** of SWF's revenue
      - Only **1.3%** of HD's revenue
      - **5%** gap
        - May eat up all SWF's EBIT margin
- But competitors offer a lower price
  - Competitors have 2 options
  - Achieve an adequate ROIC by
    - Making lower quality products
    - Offering poorer services
      - Limited warranty
      - Sell through big boxes
        - Although big box gross margin is 34%
        - Not much lower than dealer's 40%
  - Bear with a low margin
    - Low ROIC
      - Little money to reinvest
      - => may have to take debt to grow fast
  - Wild guess: competitors choose the first option

- HD has lower quality than Sherwin
  - HD turns asset 3 times slower
    - Sales/receivables
      - HD: 4.7

        - Sherwin: 9.5
    - Sales/inventories
        - HD: 4.2
        - Sherwin: 9.0
    - Sales/PPE
        - HD: 4.6
        - Sherwin: 8.9
    - Sales/NTA
        - HD: **2.1**
        - Sherwin: **6.8**
  - HD has lower margin
    - Sherwin paint business makes 18% margin
    - Paint stores have 60% gross margin
    - Sherwin experienced margin expansion
      - EBIT margin of Paint Stores business was
        - 1994: 7%
        - 2000: 13%
        - 2006: 15%
        - 2014: 18%
      - Advertising is fixed
        - Average $251 million from 1997 to 2014
        - Min: $212 million
        - Max: $299 million
        - Median: $247 million
        - Mean: $251 million
        - Standard deviation: $27 million
        - Variation: 0.11 (very stable)
      - Sherwin enjoy a bigger scale than HD
        - Paint stores revenue: $6,852 million
          - Do business in North America
        - HD's North America revenue: $1,155 million
- 8 dimensions of quality
  - Relative size
    - Globally, HD is 5 times bigger than the next competitor
    - In North America, HD is 2 times bigger than the next competitor
    - No big suppliers
    - No big fabricators

        - No big dealers
    - Focus
        - Didn’t expand into new business
        - HD has architectural products since a long time ago
            - HD Contract sells to commercial customers
                - Window blinds and shades
                - Sun-control solutions
                    - Manage heat and light inside and outside windowed walls
                    - Products include
                        - Exterior shades
                        - Skylight shades
                            - For horizontal and sloped glazing spaces
                - Ventilated Façade system
                    - Uses lightweight aluminum skins
                        - Attached to a honeycomb aluminum core
                        - Provides extreme strength and flatness
                    - Panels available in many shapes and curves
                - Suspended ceilings
                    - Metal ceiling systems
                    - A wide variety of designs and applications
                        - Including curved and specialty shapes
                    - Deliver
                        - Superior noise reduction
                        - A clean, monolithic look
    - Customer engagement
        - No information
    - Cross-selling
        - Give customers advice in the showroom
    - Retention
        - No information
    - Words of mouth
        - Very strong
    - Reinvestment rate
        - Spent $352 million on R&D since 2003

        - Spent $6.7 billion on selling and marketing expenses since 1999
    - Stock's popularity
        - Share turnover: 10%
        - 3-month average daily volume: 3,274
            - About EUR 140,000
                - $150,000
        - Extremely obscured

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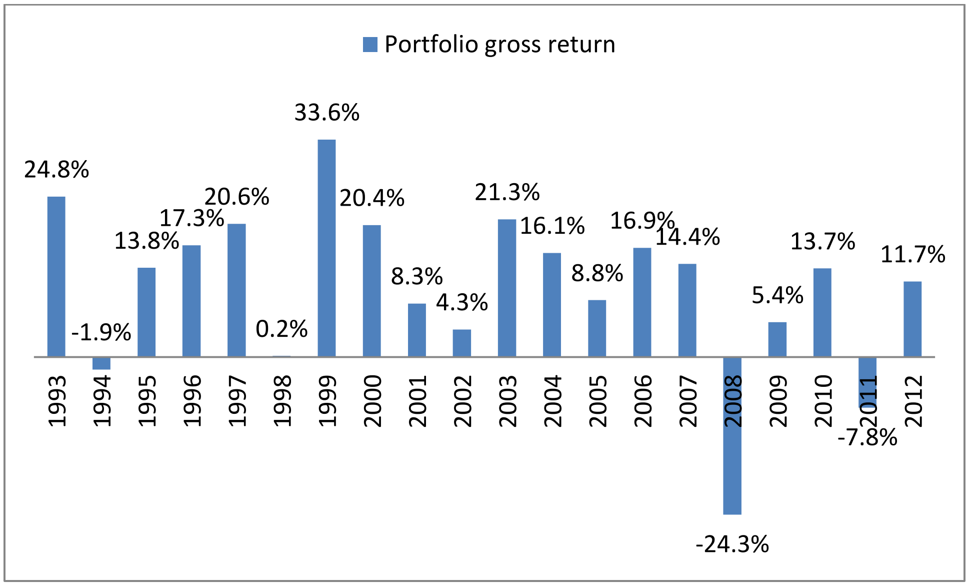
[1] "**About two-thirds of the U.S. operation's revenue comes from home renovation and remodeling, and about one third comes from new home spending, according to Hopkins**. [CEO of Hunter Douglas's U.S. operations]

That's changed from the boom days of the real estate construction, when the company got about half its revenue from each, he said." – *Hunter Douglas' Future Hangs on Innovation*, Hugh Morley, Tribune Business News, 09 November 2009

[2] "Hicks testified at trial that, throughout the 1990s, Blind Maker voluntarily chose to sell almost exclusively Graber products and considered itself the "Graber guys." Blind Maker also prided itself in being a "full line" Graber fabricator, carrying the components necessary to fabricate the complete range of Graber products. The company strove to fill and ship orders from its retail-level customers on the same day they were received. These strategies required Blind Maker to maintain large inventories-Hicks testified that **the company would frequently carry six million dollars in inventory, which would take roughly two months to turn over through sales. Hicks added that Blind Maker took around another month to collect its accounts receivable from sales**, meaning that it could take three months or more to realize cash from the sale of inventory it purchased from Springs." – Court of Appeals of Texas, Austin: Springs Window Fashions Division Inc v. Blind Maker Inc, Caselaw.findlaw.com, 20 January 2006

Capital Allocation

The Sonnenberg Handles Hunter Douglas's Cash Flow as Their Own Money



Hunter Douglas's investment portfolio made 11% annual return over 21 years ended in 2012

- There's almost no share dilution
- Hunter Douglas (HD) is controlled by the Sonnenberg family
    - Owns 81.18% of HD
    - CEO: Ralph Sonnenberg
        - Son of the founder
            - Henry Sonnenberg
    - Co-Presidents & COO's: David & Marko Sonnenberg
        - Son of Ralph Sonnenberg
- HD has made 51 acquisitions since 2001
    - Spent $684 million
        - Average $13 million per acquisition
    - Acquisitions are for vertical integration
        - Acquired 37 fabricators
            - Including a few tiny blindmakers
        - Acquired 10 component makers
            - Example:
            - Acquired Kendix
                - In 2005

        - A prominent Dutch fabric brand
    - Acquired Mermet
        - In 2005
        - A maker of glass fiber sunscreen fabric
        - Have plants in
            - Veyrins (France) and
            - South Carolina (USA)
    - Acquired ESI in 2007
        - A developer of window covering motor controls
        - Based in Broomfield, Colorado
    - Acquired Hexcelscreen
        - A manufacturer of glass fiber sunscreen fabric
        - Based in Lyon, France
- Acquired 3 companies for new products
    - Acquired 3form
        - In 2007
        - Based in Salt Lake City, Utah
        - Make translucent architectural materials
        - 3form panels are used in a wide range of interior and exterior applications
            - Back-lit wall features
            - Partitions
            - Ceiling elements
            - Horizontal surfaces
            - Canopies
            - Building accents
            - Signage
    - Acquired NBK
        - In 2007
        - Based in Emmerich, Germany
        - A pioneering manufacturer of terracotta façade
            - Complement HD’s façade business
    - Acquired Phonex
        - In 2010
        - Based in Argentina
        - A manufacturer of metal ceilings
            - Complement HD’s ceiling business

- HD usually pay less than 0.5 P/S
  - Acquired fabricators at great price since the financial crisis
    - Less than 0.3x P/S for acquisitions in 2008
      - (Estimated revenue of fabricators based on number of employees)
    - 0.46x P/S for acquisitions in 2010
    - 0.45x P/S for acquisitions in 2011
    - 0.25x P/S for acquisitions in 2012
    - 0.33x P/S for acquisitions in 2013
    - 0.34x P/S for acquisitions in 2014
- It's hard to judge whether acquisitions created value
  - The 2007-2014 period was abnormal
- Acquisitions perhaps don't destroy value
  - Acquiring fabricators result in more efficiencies
  - Acquired components can be used for a large volume

- HD has an investment portfolio
  - The Netherlands used to have 35% tax rate[1]
    - (Today the Netherlands has 25% tax rate)
    - It wasn't tax-efficient to repatriate offshore earnings
    - They invested offshore earnings in offshore funds
  - The family puts retained cash into an investment portfolio
    - Use a widely diversified range of independent managers
    - Limits risk by initially investing less than 0.5% of the total portfolio in each fund
      - Had more than 200 funds at its peak
        - In 2007
        - $849 million[2]
    - Invest in a wide range of
      - Asset classes
      - Industries
      - Geographies
      - Currencies
  - The portfolio performed very well
    - 11% return over 21 years ended in 2012[3]
      - About 14% annual return until 2007
    - Declined in **3 years**
      - 1994: -1.9%

                - 2008: -24.3%
                - 2011: -7.8%
            - Had return between 0% and 10% in **5 years**
                - 1998: 0.2%
                - 2001: 8.3%
                - 2002: 4.3%
                - 2005: 8.8%
                - 2009: 5.4%
        - HD closed the portfolio in 2013
            - But restarted in 2014
                - $116 million
                    - Invested in 41 funds
                - Will be increased to $200 million in 2015
- HD wanted to buy out minor shareholders in 2008
    - Offered to buy 13.4 million outstanding shares
        - EUR 43 each
    - HD managed to buy 6.7 million shares
        - Owners of 6.7 million shares didn't sell
    - The family increased ownership after the transaction
        - From 68.2% to 81.2%
    - HD spent $463 million on the repurchase
        - Took $451 million out of the investment portfolio in the same year
- HD has a progressive dividend policy until 2007
    - Has always paid dividends since 1969
        - When HD went public
    - Paid EUR 2.00 per share in 2007
    - Reduced to EUR 1.00 per share in 2008
    - Paid a special dividend in 2009
        - EUR 7.00 per share
        - For a total of EUR 8.00 per share
        - Paid a total of $345 million in dividends
            - Took $256 million out of the investment portfolio in 2009
    - Maintained EUR 1.25 dividend per share from 2010 to 2014
- HD may use debt for dividends and share buyback
    - Gross debt was stable between 1999 and 2006
        - Stayed between $340 million and $475 million
    - HD tend to put offshore profit into investment portfolio

            - While using debt if necessary for
                - Dividend
                - Share buyback
                - Acquisitions
            - Example:
                - In 2007
                    - Spent
                        - $116 million on acquisitions
                        - $124 million on dividends
                    - FCF was $47 million
                    - Added $40 million into the investment portfolio
                    - Gross debt increased to $647 million
                        - From $475 million
    - Gross debt has reduced since the financial crisis
        - 2008: $723 million
        - 2014: $449 million
        - HD reduced the investment portfolio during this period
            - Reduced dividend from EUR 2.00 to EUR 1.25 per share
    - HD restarted the investment portfolio in 2014
        - Gross debt may start building up overtime
    - Net debt is relatively low
        - HD has net cash during 2004-2007
        - Max net debt was $522 million
            - In 2012
            - 3x 2012 EBIT
        - Current net debt is $301 million
            - 1.5x 2014 EBIT
- Conclusions
    - Organic growth creates the most value
    - Acquisitions won't destroy value
    - The investment portfolio may have an adequate return
        - Other benefits
            - Avoid paying taxes
            - HD doesn't really build up cash
                - They can use debt for dividend and share buybacks
    - HD will continue paying dividends

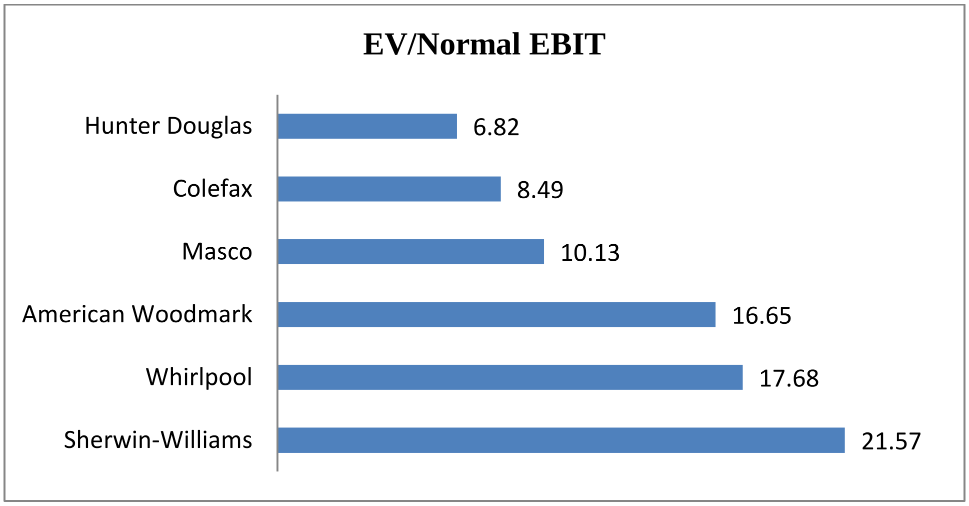
[1] "**Their stated tax rate is 35%, but 30% is more accurate in terms of what the company pays**. The kicker is that Hunter Douglas has EUR13 a share in investments -- just cash they have accumulated over the years. **It doesn't make sense to buy back stock in the Netherlands because they would owe the government something. It's not tax-efficient to pay the money out. So the company has invested this money in offshore funds.** They are very good at picking managers, as evidenced by their 15%-20% annual returns." – *The New Normal*, Barron's Roundtable Scorecard, 24 June 2002

[2] "**Hunter Douglas has had an investment portfolio since mid-1991**. **Management of the investments is delegated after screening to a widely diversified range of independent managers**. Hunter Douglas does not control or influence the manager's investments. The Net Asset Value (NAV) of the investments is determined and advised each month by the funds' administrators. Hunter Douglas monitors each manager's results on a monthly basis. **Hunter Douglas limits the portfolio's risk by initially generally investing less than 0.5% of the total portfolio in each fund. At year-end 2007, Hunter Douglas had investments in more than 200 funds in a wide range of asset classes, industries, geographies, currencies and with differing risk profiles**. The broad diversification of the portfolio reduces the risk per manager and mitigates the risk of fluctuations in markets and interest and exchange rates. **The fair value of the investment portfolio at year-end 2007 was 849 million.**" – Hunter Douglas 2007 Annual Report

[3] "**Over the 21 years of the Portfolio's existence it has produced an average annual return of 11%.**" – 2012 Annual Report

Value

Hunter Douglas Is Priced as a Neglected Stock



Hunter Douglas is 20% cheaper than Colefax

- Key inputs
  - Number of outstanding shares: 34.79 million
  - Share price: EUR 42.5 ($46.75)
  - 1 EUR = $1.1
  - Market cap: $1,626 million
    - Hunter Douglas (HD) reports in $
    - One should convert share price into $ to make a purchase decision
  - Cash + Investment Portfolio: $219 million
  - Debt: $565 million
  - EV: **$1,972 million**
  - Tax rate: Below **25%**
    - Dutch statutory income tax rate is 25%
    - The net impact of different tax rates per country is favorable
  - Current EBIT: $200 million
    - Adjusted for amortization of trademarks and non-recurring expenses
  - EV/EBIT: **9.9**
- HD's normal EBIT is **$296** million
  - Current margin is lower than normal
  - Median margin from 1996 to 2014 is 11%

    - Average margin from 1996 to 2014 is 10%
    - Margin was about 12% from 1996 to 2007
        - Min: 10%
        - Max: 14%
        - Median: 13%
        - Mean: 12%
        - Standard deviation: 1%
        - Variation: 0.11 (very stable)
    - From 2008 to 2014
        - 2009: 5%
        - 2010: 6%
        - Other years: 7%
        - Lower EBIT margin can be explained by
            - Selling and marketing expenses/Revenue increased
                - 16-17% in 1996-2007
                - 20% currently
            - Slightly lower gross margin
                - About 40% in 1996-2007
                - 41% in 2007
                - 37% in 2008
                - 39% in 2014
                - Declined due to manufacturing deleverage
    - 11% margin is a very safe assumption for normal EBIT margin
        - Implies **$296** million EBIT at current sales level
- HD can make **$350 million EBIT** in the future
    - HD can have 5% long-term growth
    - Current revenue is below 2007 level
        - Is recovering in the U.K. and the U.S. market
    - HD has snapped up fabricators during the crisis
        - Switched to a 1-step distribution model in the U.S.
    - HD should be able to make new record sales and EBIT in the future
        - Peak EBIT: **$341 million**
            - (In 2006)
    - HD's gross margin is very stable:
        - Average about 39% from 1996 to 2014
            - Min: 37%
            - Max: 42%

      - Median: 39%
      - Mean: 39%
      - Standard deviation: 1%
      - Variation: 0.04 (extremely stable)
  - There can be margin expansion by leveraging operating expense
    - Selling and marketing expense can be fixed
  - If HD makes 13% EBIT margin (as in 2006)
    - EBIT would be **$350 million**
      - Based on current sales level
- HD's EV/EBIT is low
  - Current: 9.9x
    - **13.2x after-tax earnings**
  - Based on median margin: 6.7x
    - **8.9x after-tax earnings**
  - Based on potential EBIT: 5.6x
    - **7.5x after-tax earnings**
- HD is very safe
  - EUR 1.25 dividend per share
    - 3% yield
  - The lowest EBIT margin in 19 years was 5.3%
    - In 2009
    - Implies $143 million
    - 13.8x EV/EBIT
      - 18.4x after-tax earnings
- One reason for HD's low price
  - Europe is stagnant
    - 38% of sales
  - This is nonsense in the long run
  - In the short run, the North America and UK markets are doing well
- HD's peers are very expensive
  - Sherwin-Williams (SHR)
    - Share price: $288.18
    - EV: $29.6 billion
    - EV/EBIT: **22**
    - EV/Pre-tax Owner Earnings: **21.6**
      - (adjusted for amortization of intangibles)
    - Sherwin is a better peer

            - Higher margin
            - Higher turnover
            - => much higher ROIC
                - > 100% ROIC
            - Not much higher growth
                - From 1996 to 2014:
                    - Sherwin's annual sales growth: 5.7%
                    - HD: 4%
        - Sherwin deserve a higher multiple
            - But 22 EV/EBIT is ridiculous
- Whirlpool (WHR)
    - Share price: $184.25
    - EV: $19.28 billion
    - EV/EBIT: **16.23**
    - EV/Pre-tax Owner Earnings: **17.68**
        - = sales * Median EBIT margin
    - Whirlpool isn't better than HD
        - Lower gross margin: about 21%
            - HD: 40%
        - Comparable EBIT margin: 9%
        - Comparable EBIT/NTA: 28%
        - Long-term growth: 4.8%
            - 1992: $7,097 million
            - 2014: $19,872 million
    - Whirlpool is a bit less cyclical than HD
        - And has a more consistent growth
    - But HD can have strong potential growth
        - Thanks to favorable trends
        - And after a long period of stagnation
        - (See more at Growth section)
    - Whirlpool doesn't deserve a higher multiple than HD
- Masco (MAS)
    - Share price: $27.07
    - EV: $11.2 billion
    - EV/EBIT: **14.36**
    - EV/Pre-tax Owner Earnings: **10.13**
        - = sales * Median EBIT margin

- Masco has a number of business
  - Better or worse than HD
  - Decorative Architectural Products are better than HD
    - Paint business
    - **23%** of Masco's revenue
  - Plumbing products can be better than HD
    - Margin was high throughout the financial crisis
      - Over 10%
    - **39%** of Masco's revenue
  - Other businesses are worse
  - Cabinets and related products
    - 12% of revenue
    - Keep losing money
    - No sign of recovery
  - Other Specialty Products and Installation and Other Services are typical of housing products
    - Very cyclical
    - Lost money during the crisis
    - Are recovering
- Using Sales * Median margin is assuming a full recovery
  - Masco's EV/Fully recovered EBIT is 10.13
    - Still higher than HD's EV/current EBIT

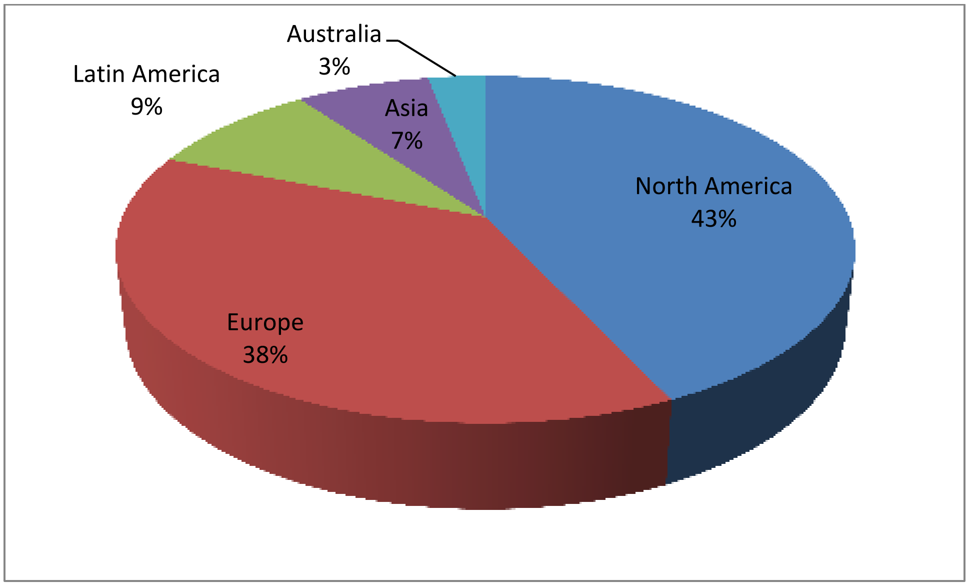
- American Woodmark (AMWD)
  - Share price: $51.34
  - EV: $713 million
  - EV/EBIT: **20.98**
  - EV/Pre-tax Owner Earnings: **16.65**
    - = sales * Median EBIT margin
  - AMWD makes kitchen cabinets
  - AMWD isn't a franchise like HD
    - Kitchen cabinets are commodity
  - AMWD's gross margin is about 17-20%
  - The business is very cyclical
    - Revenue declined over 50% during the crisis
      - 2006: $838 million
      - 2010: $407 million
  - AMWD lost a lot of money as a result

            - 2008: $4 million EBIT
            - 2009: $3 million EBIT
            - 2010: **-$34** million EBIT
            - 2011: **-$31** million EBIT
            - 2012: **-17** million EBIT
        - AMWD's current revenue is 13% below the 2006 level
            - EBIT margin is 5%
            - Below historical average of 6%
        - EV/(Sales * Median EBIT margin) is 16.65
            - Too high
            - Doesn't make sense
    - Colefax (LON:CFX)
        - Share price: £4.26 ($6.52)
        - EV: £42 million ($64 million)
        - EV/EBIT: **8.5**
        - EV/Pre-tax Owner Earnings: **8.5**
            - = sales * Median EBIT margin
        - Colefax makes luxury wallpapers
        - The product economics is very good
            - Less cyclical than window blinds and shades
                - Revenue declined only 14% during the crisis
                - 2008: £78 million
                - 2010: £67 million
                - Less dependent on new homes
            - Gross margin is high: 55%
        - But the scale is too small
            - => high operating expenses
            - => only 6% EBIT margin
            - 25% EBIT/NTA
        - Colefax doesn't have a strong brand awareness like HD
        - Very low growth
            - Only 1.5% since 2000
        - HD deserves a higher multiple than Colefax
        - Colefax's EBIT is 8.5x
            - A bit lower than HD
        - Perhaps because Colefax is illiquid

- 3-month average volume: 1,822 shares
    - Less than £8,000 a day ($12,000)

Growth

People around the World Will Switch from Curtains to Blinds and Shades



Latin America and Asia account for only 16% of Hunter Douglas's revenue

- Blinds and shades enjoy a favorable secular trend
  - Switch from curtains
    - Blinds and shades offer some advantage over curtains
      - Light control
      - Energy efficient
      - Maximize the usable spaces in existing properties
    - Curtains lose market share overtime
      - Hold 95% market share in places like India
      - Hold 50% market share in many developed market
        - 45% in the U.K.[1]
        - 26% in the U.S.
      - In the U.K.
        - Sales of blinds grew 60% between 2001 and 2006[2]
          - (Blind also means shade in the U.K.)
          - Reach £445 million in 2006
        - While curtains remained static at £640 million
  - People spend more on window treatments
- HD had grown nicely up until the financial crisis
  - 1996-2007 annual revenue growth was **8%**

        - 1996: $1,327 million
        - 2007: $3,028 million
    - In North America
        - 1999-2006 annual sales growth of window coverings was **9%**
            - 1999: $690 million
            - 2006: $1,229 million
    - In Europe
        - 1999-2007 annual sales growth of window coverings was **10%**
            - 1999: EUR 360 million
            - 2007: EUR 784 million
    - In Latin America
        - 1999-2008 annual sales growth of window coverings was **11%**
            - 1999: $59 million
            - 2008: $154 million
        - Growth might be understated because of currency devaluation
    - In Asia
        - 1999-2011 annual sales growth of window coverings was **13%**
            - 1999: $20 million
            - 2011: $86 million
- HD revenue is currently below pre-crisis level in the North America and Europe
    - North America: **17%** below 2006 sales
        - 2006: $1,229 million
        - 2014: $1,019 million
    - Europe: **20%** below 2007 sales
        - 2007: EUR 784 million
        - 2014: EUR 631 million
    - Sales declined less in the Europe during the crisis
        - Europe: 26% decline between 2007 and 2009
        - North America: 33% decline between 2006 and 2009
    - But Europe is recovering more slowly
        - Improved performance in
            - The U.K.
            - Ireland
            - Scandinavia
            - The Benelux
        - But remain stagnant in other main markets

                - France
                - Spain
- HD can have 4-5% long-term growth
    - Track GDP growth in developed markets (84% of sales)
        - North America: 43% of sales
        - Europe: 38% of sales
        - Australia: 3% of sales
        - Growth can be faster than GDP if blinds and shades increase penetration
    - Can have high growth in developing markets (16% of sales)
        - Latin America: 9% of sales
        - Asia: 7% of sales
        - Quan's observation: Vietnamese mostly use curtains
            - That might change as they have more disposable income
                - And are more educated about window treatments
- HD's annual sales growth was 4% between 1996 and 2014
    - 1996: $1,327 million
    - 2014: $2,695 million
    - Went through 2 crisis
        - A short dot com bubble
        - A long Great Recession
- There can be a period of strong growth
    - After a long period of stagnation
    - Example:
        - Annual sales growth was 14% between 2002 and 2007
            - 2002: $1,590 million
            - 2007: $3,028 million
        - After a flat period between 2000 and 2002:
            - 2000: $1,570 million
            - 2002: $1,590 million

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[1] According to AMA Research

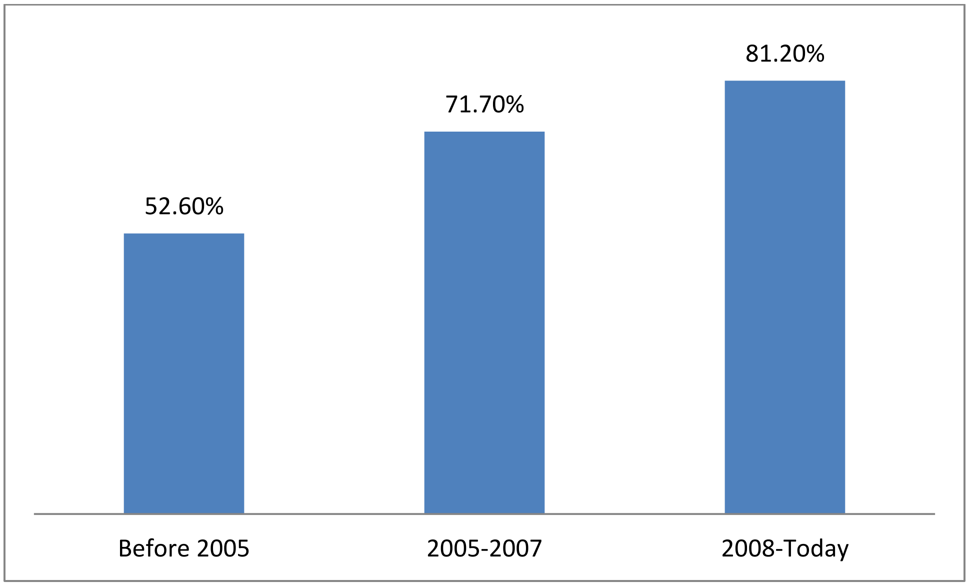
[2] "**Once all it took was the twitch of a net curtain, but now Britain's nosey neighbours are more likely to be peering round a blind or spying through a shutter. Latest research from MINTEL finds sales of blinds grew by a**

massive 62% between 2001 and 2006, to reach £445 million, with the sector benefiting from the growing trend for simple and casual decor in the home.

But it is shutters that are the star performer in the window furnishings market. Although they account for just 5% of the blinds market, sales of shutters grew by a blinding 44% between 2004 and 2006 alone, to reach £23 million. By contrast, **sales of curtains have remained almost static at around £640 million**, with value sales increasing by just 2% over the same two year period." Mintel Research, 2006

Misjudgment

What if the Sonnenberg Take Over Hunter Douglas?



The Sonnenberg family has increased ownership to 81.2% of common shares

- We may misjudge the competitive position in Europe
    - HD operates under the Luxaflex brand in Europe
    - There's little information on the news
    - We only do scuttlebutt in the U.S.
    - Guess: HD has smaller competitors in Europe
        - Springs Window Fashions is the second biggest global competitor
            - But does all business in North America
        - HD supplies components to independent blindmakers in Europe
    - HD's revenue in Europe is close to the U.S.
        - In 2007
            - North America: $1,216 million
            - Europe: $1,078 million
        - In 2014
            - North America: $1,019 million
            - Europe: $836 million
    - The market size can be similar between North America and Europe
- Why is Asia so small?
    - Asia contributes only 7% of revenue

- Japan should be a big market for HD
    - Japan account for almost 6% of Stressless revenue
    - Is it because houses in Japan are too small?
        - There's few need for window blinds?
- Quan's observation: Vietnamese mostly use curtains
    - That might change when people have more disposable income
        - And are more educated about window blinds and shades

- The Sonnenberg family may want to take over HD
    - In 2005
        - Ralph Sonnenberg controlled 22,075,148 common shares
            - 52.6% of total outstanding shares
        - Bergson made a tender offer to buy 10.5 million shares
            - Bergson is controlled by Ralph Sonnenberg
            - He said HD is a good long-term investment
            - Target price was EUR 46.00
                - 24% premium above the closing price
                    - EUR 37.00
                    - On May 2, 2005
                - 17% premium above the previous 3-month average closing price
        - The clearing price was EUR 44.00
            - For about EUR 465 million
            - Bergson got loan from ING
        - After the transaction, Ralph Sonnenberg controlled 30,075,148 shares
            - 71.7% of total issued common shares
    - In 2008
        - HD intended to buy up to 13.4 million shares
            - Through a public offer of EUR 43.00 per share
            - 17.1% premium above the closing price
                - EUR 36.73
                - On March 12, 2008
        - The share purchase would be financed by HD's investment portfolio
            - Following recent changes in the Dutch tax legislation[1]
                - A purchase of Hunter Douglas of its own common shares would be free of Dutch withholding tax

        - 6,774,741 shares have been tendered
            - Total repurchase of EUR 463 million
    - Currently, Ralph Sonnenberg controls 28,764,039 shares
        - 81.2% of total
    - His sons were appointed Co-President and COO
        - In 2008
        - David Sonnenberg
            - Was 41 years old then
        - Marko Sonnenberg
            - Was 38 years old then
        - Both had been active in the company for over 15 years
    - The appointment formalized a long-term succession plan
- If the Sonnenberg family acquires 95% or more of total shares, they would be able to delist the company[2] [3]
    - They can buy out the remaining minority shareholders via proceedings at the Enterprise Chamber
        - A special division of the Amsterdam Court of Appeal
        - The court will determine what the fair price is

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[1] "Hunter Douglas, the world market leader in window coverings and a major manufacturer of architectural products, announces its intention to **offer to purchase for cash up to 13.4 million common shares held by its minority shareholders, through a public offer of EUR 43.00 per common share**. The proposed offer will not be conditioned upon any minimum number of common shares being tendered and **is not extended to the 28.8 million common shares held by Bergson, a Dutch corporation controlled by Mr. R. Sonnenberg**. The offer price of EUR 43.00 per common share implies a **premium of 17.1%** above the closing price of EUR 36.73 on March 12, 2008.

Following recent changes in the Dutch tax legislation, a purchase by Hunter Douglas of its own common shares will be free of Dutch withholding tax.

Hunter Douglas will finance the proposed offer through a reduction of its investment portfolio and bank facilities." – *Hunter Douglas intends to offer to purchase for cash up to 13.4 million of its common shares through a public offer*, Hunter Douglas Press Release, 13 March 2008

[2] "**Delisting After a Successful Public Offer**

After the offeror has made a successful public offer, the offeror may decide to delist the target company from NYSE Euronext Amsterdam. For obvious reasons terminating the listing is generally desirable to allow integration and to avoid the need to comply with disclosures and other rules applicable to listed companies.

The policy of NYSE Euronext Amsterdam with respect to delisting shares is laid down in an announcement. Pursuant to the announcement shares of a certain type can be delisted from NYSE Euronext Amsterdam's stock exchange at the request of the offeror or the target company, including in case the offeror holds at least 95% of the shares after the public offer becomes unconditional, and the target company agrees to the delisting.

Delisting is generally also possible in consultation with NYSE Euronext in case of alternative transaction structures that take place after or instead of a public offer, for instance in case of a legal merger or an asset sale followed by a liquidation of the target company, provided the target´s shareholders receive the full amount of liquidation distribution.

If the applicable conditions are met and the target company or offeror wants to proceed with the delisting, a request to that effect must be submitted to NYSE Euronext Amsterdam. If NYSE Euronext Amsterdam decides in favour of the request, delisting will take place 20 trading days after publication of the decision, or later if this is specified in an exit arrangement.

Squeeze-Out, Sell-Out and Buy Out Proceedings

Statutory squeeze out and sell out rights after a public offer

If the offeror has acquired 95% or more of the issued share capital after a public offer of the target company, the most common way to acquire 100% of the target company's shares is through the statutory squeeze-out proceedings. By means of this procedure, the remaining shareholders can be forced to transfer their shares to the offeror. The squeeze-out proceedings may be initiated against the remaining shareholders if after a public offer one or more co-operating shareholders provides 95% or more of the share capital of the target company, which also represents at least 95% of the voting rights of the share capital of the target company. In addition, the remaining shareholders of the target company have a sell-out right against the offeror if the offeror has acquired 95% of the share capital representing at least 95% of the voting rights.

Both the sell-out and the squeeze-out proceedings must be initiated within 3 months after the acceptance period of the public offer has ended and must be brought before the Enterprise Chamber of the Amsterdam Court of Appeal. If the claim is honoured, the court will determine what the fair price will be for the transferred shares in the target company. If 90% of the shareholders have accepted the public offer, the offer price is presumed to be a fair price for the shares of the minority shareholders. Notwithstanding this presumption the Enterprise Chamber may appoint independent experts to determine a fair price.

Regular statutory buy out proceedings

In addition to the statutory squeeze out right of offerors after a successful public offer as described above, a separate "regular" statutory buy out right exists for a shareholder that has 95% or more of the share capital and voting rights in a Netherlands limited company (BV or NV), Such shareholder can buy out the remaining minority shareholders via proceedings at the Enterprise Chamber. The main differences between "regular" buy out proceedings and the aforementioned squeeze out proceedings after a public offer, are that there is no requirement to initiate buy out proceedings within a 3-month period after a public offer (as with squeeze out proceedings) and the aforementioned `fair price´ presumption does not apply to regular buy out proceedings." - **The Netherlands Takeover Guide by Christiaan de Brauw**

[3] "7.8.2 Delisting At the Initiative of the Issuer

Delisting at the initiative of the issuer may occur (a) on a request to that effect from the issuer; (b) automatically when the securities cease to exist; for example on redemption or cancellation of the securities; or (c) automatically when the issuer ceases to exist altogether, for example when the issuer is dissolved or merges into another entity.

There are no regulation in the Euronext rules concerning issuer delisting request other than where it concerns shares or depositary receipts for shares. For all the securities this means Euronext may entertain such delisting requests and honor or reject them as it sees fit. Delisting requests must be substantiated. If it decides to grand the delisting request, Euronext must determine the date on which the delisting becomes effective.

For shares and depositary receipts for shares, Euronext has developed a policy on when it will grant a delisting request. A request can apply to one class of shares or all classes. Euronext will grant a delisting request:

(a) If the securities have also been listed for at least twelve months on another regulated and sufficiently liquid market that offers, in Euronext's opinion, adequate safeguards for the protection of investors and the proper functioning of the market;
(b) If a public offer for all securities is declared unconditional and the bidder has at least 95% of those securities and the target (the issuer) agrees with the delisting;
(c) If a single shareholder or several shareholders acting in concert, hold at least 95% of the securities other than as a result of a public offer, the issuer agrees to a delisting and the minority shareholders are offered an 'exit arrangement', defined as:
    (i) A public offer in accordance with statutory law;
    (ii) Legal proceedings concerning a forced minority buyout
    (iii) A buyback offer by the issuer itself, that remains open for a period of at least twenty trading days; or
    (iv) Any other arrangement that meets Euronext's requirement regarding the protection of investors and the proper function of the market based on an exemption from the AFM (The Netherlands Authority for the Financial Markets) of the statutory public offer laws. A press release must be published specifying that: (i) it applies to all remaining securities; (ii) the offer shall remain open for twenty trading days; (iii) the offer is based on the exchange price and/or the intrinsic value of the securities prior to the initial announcement of the exit arrangement.

It is difficult to envisage how the exit arrangement under (d) can be achieved. Publishing a press release on the arrangement means that it will almost automatically qualify as a public offer which means the statutory public offer rules will have to be complied with. There are no known cases where the AFM granted an exemption from these rules. The exit arrangement under (c) (the buyback offer) will be easier to use as buyback offers are always exempt from the statutory public offer rules.

There is no option to delist with shareholders' consent, not even pursuant to a shareholder vote carried by the disinterested minority. The Euronext rules prescribe that the shareholder protection must take the form of an opportunity to sell, not to vote.

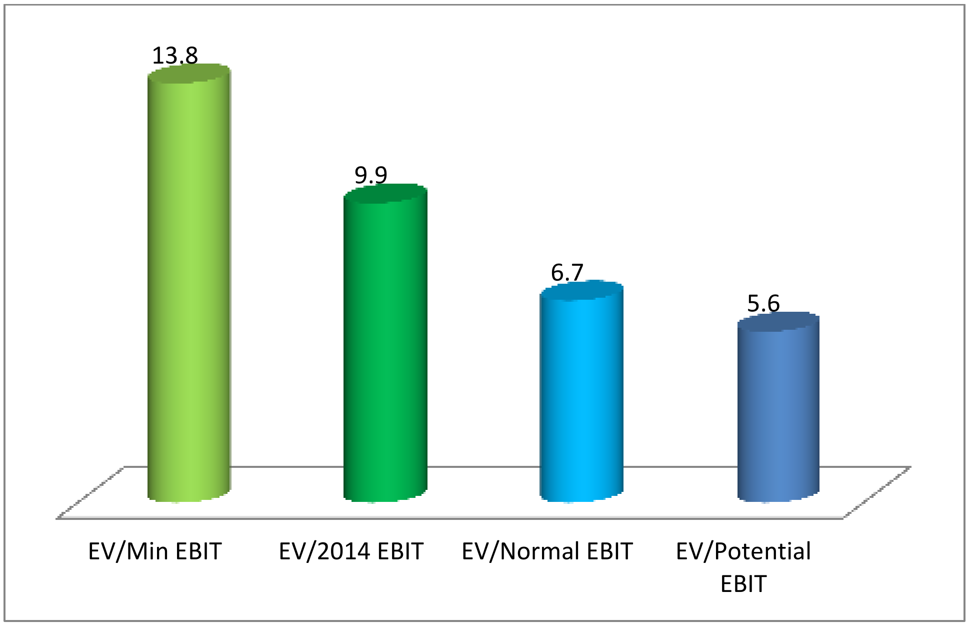
The ability to delist will be a focal point in the restructuring of public offers. If the bidder acquires 95% or more, it will usually follow the route of the legal buyout proceedings. If it acquires less, it will need to seek alternatives. A buyback offer has the disadvantage that it is voluntary and does not guarantee a 100% ownership. The alternative are: to merge the issuer into the bidding vehicle or any of its group companies, the downside being that the minority cannot be cashed out but must be offered shares; and an asset deal followed by liquidation, which can also be cumbersome. See Chapter 8.

The delisting procedure starts with a written request for delisting, stating in respect of which securities delisting is requested as well as the grounds for delisting. If Euronext decides in favour of the request, it will then determine and publish the date on which delisting will take place. This date is normally twenty trading days after publication of the decision or later if this is specified in an exit arrangement. Euronext will also publish any conditions of delisting and any other relevant information concerning the delisting.

Delisting from alternext can be difficult too. Public offers for securities listed on Alternext are exempt from the statutory public offer rules and thus are easier to structure. But a delisting can be done only where the bidder has obtained 95% of the voting rights (i.e., 95% of all of the outstanding voting equity, not just the listed class of shares), and makes an offer to buy out minority shareholders during a period of at least ten business days, on condition that the offer price has received a fairness opinion from an independent expert." - Financial Law in the Netherlands by Marcel C. A. Nieuwenhuijzen

Conclusions

Hunter Douglas: Good Business, Great Price, Not a Perfect Investment



Hunter Douglas is trading at 5.6x potential EBIT

- Hunter Douglas (HD) is a good business at great price
  - Very durable
  - Great competitive position
    - Strong brand
    - Market share of home products don't switch often
      - A mundane business
  - The management treats HD's cash like their own money
    - Won't destroy value
  - Can have good long-term growth
    - Enjoy industry tailwind
  - Price is safe
    - 3% dividend yield
    - 13.8x EV/Min EBIT
      - Using the lowest EBIT margin
      - 18.4x after-tax earnings
    - 9.9x EV/Current EBIT
      - 13.2x after-tax earnings
    - 6.7x EV/Normal EBIT

            - Using long-term median EBIT margin
            - 8.9x after-tax earnings
        - 5.6x EV/Potential EBIT
            - **7.5x** after-tax earnings
- HD deserves 13x EV/EBIT
    - This is a great franchise
    - But not as good as Sherwin-Williams
    - Sherwin deserves 20x after-tax earnings
    - An average company deserves 15x after-tax earnings
    - HD should trade closer to Sherwin than an average business
    - 17.5x after-tax earnings is an appropriate multiple
        - Equivalent to 13x EV/EBIT
- The only risk is the family taking over the company
    - They can totally use debt to buy out minority shareholders
    - But they restarted the investment portfolio recently
        - They may use the investment portfolio to buy out minority shareholders someday
            - They'll have to do through a public offer
                - Or tender offer
            - Pay a premium over trading prices
                - (Not the intrinsic value)
        - That makes HD a less than perfect buy-and-hold investment