



## Mid-Quarter Newsletter

August 15, 2011

### From My Corner

Jeff Mengis – President

Some attention has been given to a recent news story that reported Apple having more cash than the U.S. Government, \$76.2 billion vs. \$73.8 billion respectively. Additionally, according to the Wall Street Journal, companies within the S&P 500 (excluding financials) are sitting on nearly \$1 trillion in cash and liquid assets. Following the recent recession, many corporations cut costs and were able to take advantage of the low rate environment by extending the maturity of their debt. As a result, corporate balance sheets are arguably in the strongest financial position they have been in for over 50 years.

With this cash, companies have the option to pay dividends, buy back stock, grow the business internally or buy other companies. The Wall Street Journal reported that the dividend payout ratio, which is the percentage of net income distributed as dividends, is at a 75 year low. Despite that low payout ratio, the dividend yield of the S&P 500 is slightly higher than the ten-year Treasury following the recent flight to safety. Given the earnings power of many companies and the cash on corporate balance sheets, we think there is upside to the dividends that they currently pay. Our portfolios lean toward companies paying a healthy dividend and have the cash flow to support it. This type of stock tends to be less volatile during market corrections. For example: Intel offers a 4% yield with potential upside and is backed by \$13 billion in cash net of debt. Using a long-term approach, we believe Intel is a better investment than the 10-year Treasury yielding 2% with minimal upside, especially when considering current U.S. debt levels.

### Investment Focus:



With 74 vessels, **EnSCO International (Ticker: ESV)** is the second largest deepwater

drilling company in the world. As global demand for oil increases, energy companies will presumably pursue more offshore drilling. Recent major discoveries by Exxon Mobil and Petrobras support the likelihood of increased deepwater drilling. EnSCO is positioned to benefit from this trend due to their newer high-end fleet, including 6 new vessels being delivered over the coming year. Their company is geographically balanced on five continents with 72% of revenues coming from outside the U.S., making them less prone to the regulations of any one country or region.

In May, EnSCO acquired Pride International in an effort to expand their fleet and their geographic footprint to include Western Africa and South America. So far, the acquisition appears to be making headway; with recent guidance increasing the expected synergies. However, we continue to monitor progress of the acquisition closely. As a result of their Pride purchase, EnSCO has about 30% debt-to-capital, which is on par with industry averages. The company has a \$9 billion contracted revenue backlog through 2015 providing some certainty for debt coverage. We see the opportunity for robust profit growth as oil supply constraints increase the demand for drilling rigs. The stock currently trades at about 8X 2012 consensus earnings and offers a dividend yield greater than 3%.

