

Strategy and Value

- 1 Who's Really Winning?
 - 3 Who Are the Return Champs?
 - 5 Perspectives on Performance
 - 7 Becoming Value-Oriented
 - 9 CEO Performance 100
-

Graziadio Business Review

April 2012

SCCO International CEO Performance 100

CEO Performance of Southern California's Largest Companies





Who's Really Winning?

Cultural commentators have recently described the millennial generation as the **“Everyone gets a medal generation.”**

The criticism leveled is that by providing this generation with undifferentiated praise, they are not being prepared for the real world, where in fact there are winners *and* losers.

Lately, there seem to be a lot of millennial corporate rankings where all companies are hailed regardless of performance. This approach fails to distinguish those CEOs who have successfully developed and executed upon innovative and differentiated strategies.

We decided to take a different approach and evaluate “Who’s Really Winning” among 100 CEOs of Southern California’s largest public companies.

Given that a CEO’s primary duty is to build an organization that delivers sustainable improvements in long-term value, the yardstick we’ve chosen for evaluating CEO performance is economic profit. We chose economic profit because it is a measure of true value creation that takes into consideration the profits a company makes over and above the level of investors’ required returns on the capital invested by the company.

In 2011, which was a year of strong profitability for many companies, 58 out of the 100 CEOs included achieved a positive economic profit. Conversely, 42 companies, or more than 40%, delivered negative economic profits by earning returns below their cost of capital.

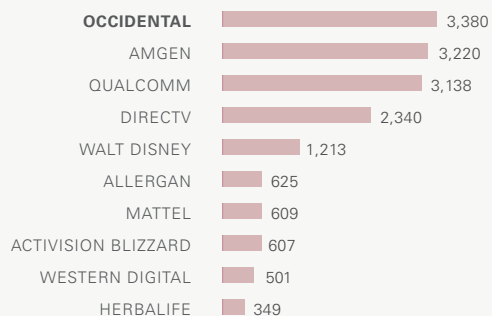
By focusing on economic profit in our ranking, we have differentiated those companies that are truly creating value from those that are not. While this ranking focuses on one year of performance, the market rewards companies that consistently improve economic profit year over year with increases in share price (see p. 6).

The 2011 winners have demonstrated strong leadership, effective strategies, disciplined execution, and a commitment to building an organization focused on long-term value. Future winners will follow the same path.

Top and Bottom 10 Value Creators – 2011 Economic Profit

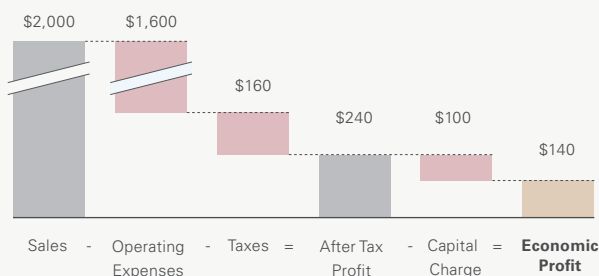
Top 10 Value Creators

\$ MILLIONS



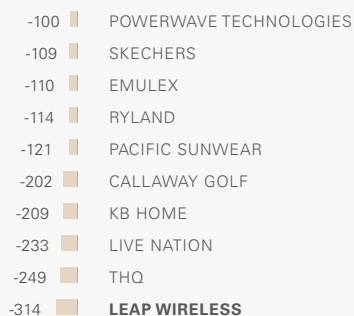
Economic Profit at a Glance

ILLUSTRATIVE



Bottom 10 Value Creators

\$ MILLIONS



Economic Profit is profit after tax and a notional charge for capital invested in the business

Capital Charge is invested capital x cost of capital e.g., $\$1,000 \times 10\% = \100

Invested Capital = working capital + net assets

Cost of Capital = investors' required return

Top and Bottom Economic Profit

1st PLACE PODIUM

Occidental Petroleum

For 2011, **Occidental Petroleum's** Stephen Chazen moves into the #1 spot for highest absolute value creation with \$3.4 billion of economic profit, an increase of \$1.6 billion over its 2010 results. Occidental captured the top spot by growing revenues over 25% to \$24.1 billion and increasing profits by just under 40% to \$7 billion, while growing its average capital base by only 15% to \$42.6 billion.

DEFEATED

Leap Wireless

From 2006–11, **Leap Wireless's** S. Douglas Hutcheson more than doubled revenues from \$1.2 billion to over \$3.0 billion. This appears impressive at first glance but a closer look reveals both negative profits and an increase in average capital invested in the business of \$2.7 billion over the same period. This combination of weak profits and aggressive investment resulted in negative economic profit of \$314 million in 2011 and earned Leap Wireless the #100 spot in our ranking.



Who Are the Return Champs?

Southern California's corporate landscape is dominated by mid-size companies. Excluding the largest ten companies, **average annual sales in 2011 was \$1.2 billion**. To recognize performance over this broad company universe, we have chosen to also rank CEOs according to their value spread, the difference between their company's return on capital and their cost of capital.

Although growing economic profit, which combines efficiency and size in one number, should be the long-term maximizing objective, looking at value spread allows us to standardize for size and compare all CEOs in terms of how well they have employed investors' capital.

Two value all-stars, **Herbalife** and **Qualcomm**, are the only companies to make it onto both Top 10 lists. Their individual performances are instructive on how different combinations of profitability and capital investment result in economic profit and value.

Southern California's Rising Stars

ALL-STAR

Herbalife

In 2011, **Herbalife's** Michael Johnson increased the company's already impressive 2010 value spread of 37% to a spectacular 52% on sales of over \$3.5 billion and a capital base of \$674 million, which resulted in \$349 million of economic profit. Interesting to note, Herbalife is the smallest company in revenues out of our Top 10 value creators, a testament to the ability of Michael Johnson to focus the organization on what matters.

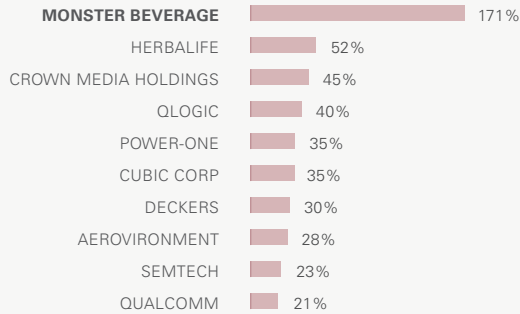
ENDURANCE STAR

Qualcomm

Dr. Paul Jacobs led **Qualcomm** to a spot on both Top 10 lists. In 2011, Qualcomm delivered a 21% value spread on a capital base of \$14.9 billion to generate economic profit of \$3.1 billion. Amazingly enough, Qualcomm earned its 21% value spread on a capital base greater than four times the amount of capital employed by the other nine companies in the Top 10 for value spread combined. Who says large companies can't maintain a strong competitive advantage?

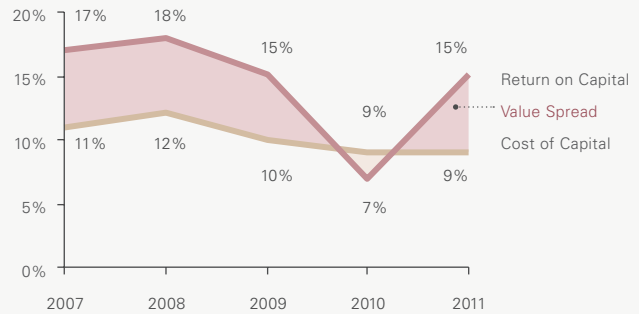
Top and Bottom 10 - 2011 Value Spread

Top 10 Value Spread

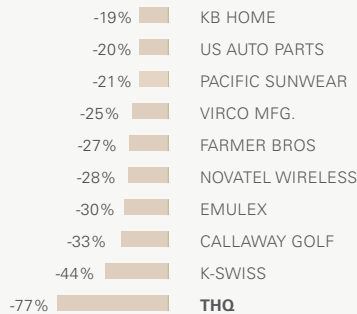


What Is the Value Spread?

ILLUSTRATIVE



Bottom 10 Value Spread



Value Spread = Return on Capital - Cost of Capital

2011 Return on capital	15%
- 2011 Cost of capital	9%
= 2011 Value Spread	6%

Value is created when a company's return on capital is above its cost of capital and, conversely, value decreases when a company's return on capital is less than its cost of capital.

The average value spread for the 100 companies in this ranking was 2%.

The High High and the Low Low

CHAMP

Monster Beverage

Rodney Sacks led **Monster Beverage** to its second straight year as the #1 company in our value spread ranking. In 2011, its value spread was 171%; and over the last three years it averaged 143%. The company recently changed its name from Hansen Natural to Monster Beverage to highlight its Monster Energy brand. The new name also aptly describes its value creation capabilities.

BENCHED

THQ

Sales at Brian Farrell's **THQ**, a developer and publisher of interactive entertainment software, have slid from approximately \$1 billion in 2006 to \$771 million in 2011. During that same time, the company's value spread has declined from a positive 3% to a negative 77%. In January, THQ announced an updated business strategy to take them to the next level but it won't be easy in this rapidly evolving industry.

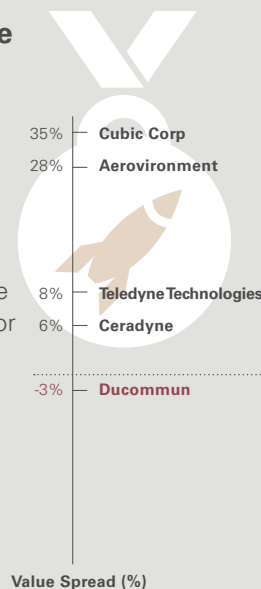
Perspectives on Performance

Good Industry or Good Leadership?

It seems intuitive that different industries should have differing return profiles; however, for select Southern California companies, the data suggests that variations in performance are driven more by differences in leadership, strategy and execution than by overall industry characteristics.

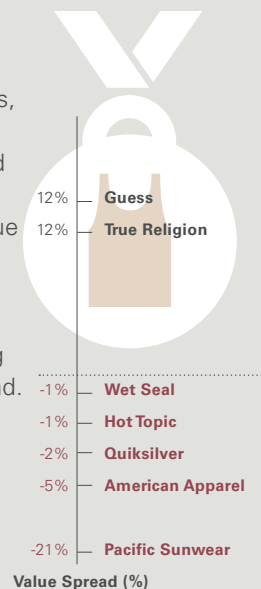
Aerospace and Defense

Walter Zable's Cubic Corp. has successfully navigated the rapid pace of change in its mission support, transportation and defense businesses to achieve profitable growth and lead the Aerospace and Defense sector with a 35% value spread.



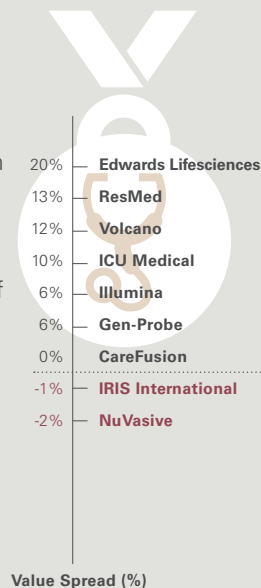
Retail Apparel

Paul Marciano, CEO of Guess, and Jeffrey Lubell, CEO of True Religion, have separated themselves from the competition by earning a value spread of 12% and sharing the #1 spot in the Retail and Apparel industry where no other company in our ranking earned a positive value spread.



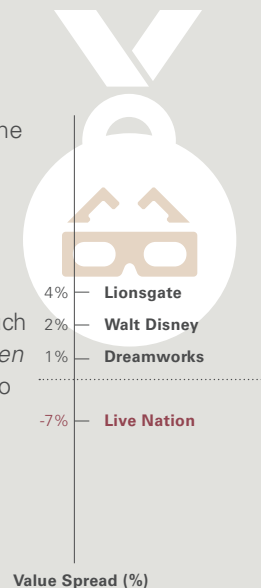
Medical Equipment

Edwards Lifesciences, led by CEO Michael Mussallem, earned a 20% value spread in 2011 and the top spot in the Medical Equipment industry through its focus on and innovation in the treatment of cardiovascular diseases.



Entertainment

Jon Feltheimer's Lionsgate had a breakout year to lead the Entertainment industry with a value spread of 4%, which was its first positive spread in the last five years. Going forward, financial discipline paired with continued hits such as *The Expendables*, *Mad Men* and *Hunger Games* are key to continued success.



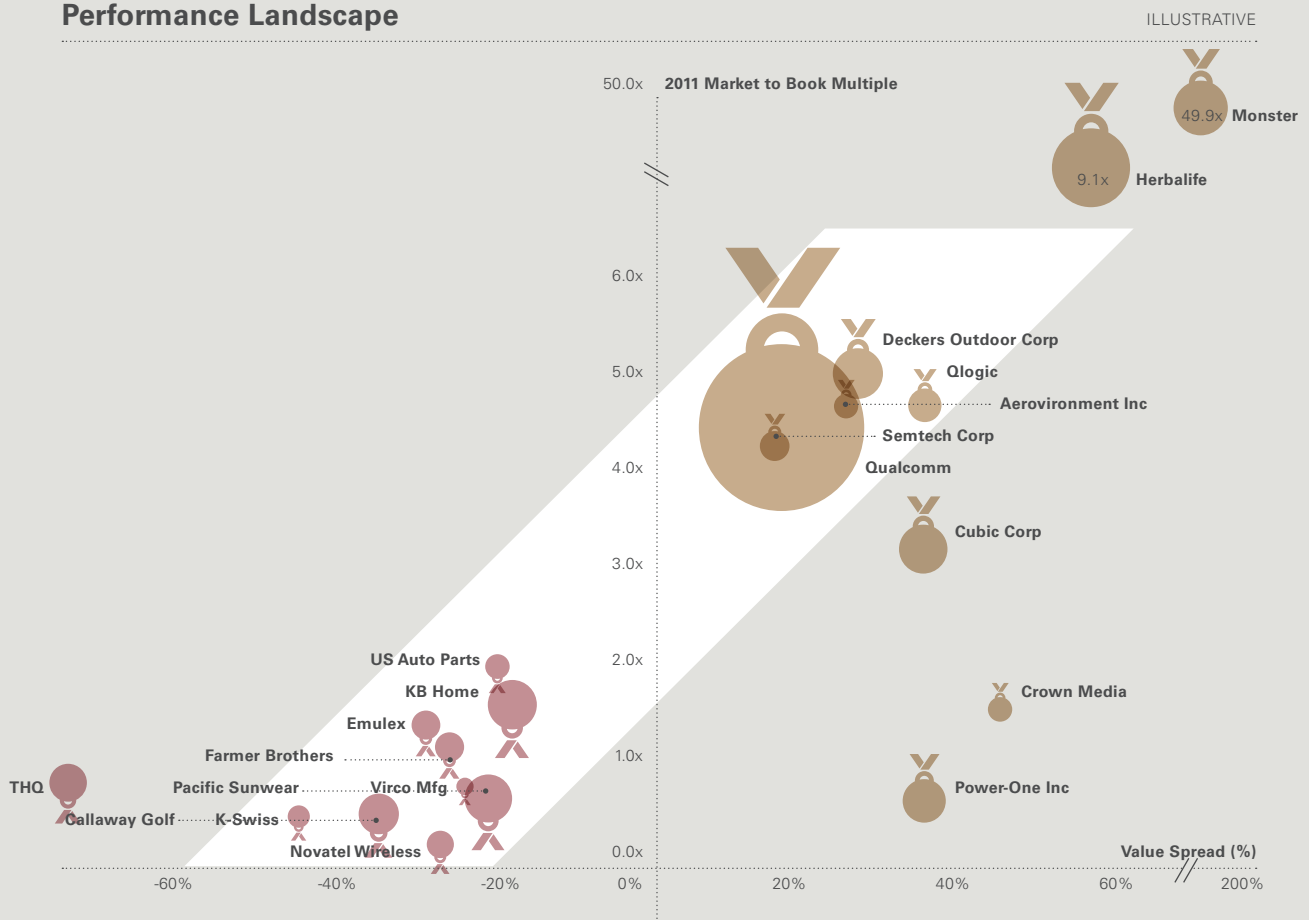
A Look at Value Spread

Increase Your Value Spread – Increase Your Share Price

We have included select companies in the captioned Performance Landscape according to their market to book multiple and value spread. The market rewards companies that earn a high value spread with high market to book multiples and penalizes those that earn low value spreads with low market to book multiples.

From a strategic perspective, companies with a positive value spread (signified by upright medals) should focus on growth since growth in economic profit increases value. While companies earning a negative value spread (signified by upside-down medals) will generate relatively more value by focusing first on improving margins and capital efficiency to improve their value spread. High growth with a negative value spread will only drive down economic profit, cash flow and value.

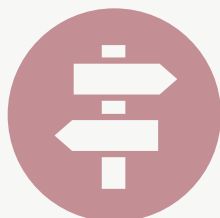
Performance Landscape



Medal size reflects relative company revenue

Note: Market to Book Multiple = Enterprise Value / Invested Capital

Four Steps to Becoming a Value-Oriented Company



1 Understand your industry's competitive dynamics

Ensure your company has a disciplined approach to understanding where opportunities exist in your industry's value chain. Your understanding must include a deep knowledge of your performance compared to competitors, your positioning with customers, and your pricing power and cost structure. This understanding is the foundation for developing a winning strategy that creates long-term value.

2 Focus on strategies that provide competitive advantage

The strategy you choose should be one your organization can execute and that will deliver growth at a positive value spread. The key component of generating long-term value is a sustainable competitive advantage (i.e., price premium, cost efficiency and/or capital efficiency) coupled with a robust capital allocation process to protect and leverage your competitive advantage.

3 Align your organization for improved decision-making

The goals of this step are to ensure that the right people are in the right positions and to provide them with the required technology and key processes to be successful. Key processes include integrated value planning (strategic and annual), capital allocation, performance management and aligned incentives that reinforce the strategy.

4 Execute, monitor and adapt accordingly

To be competitive, it is critical that proper feedback loops are provided to teams on a frequent basis to support and reinforce direction. This feedback enables companies to respond and adapt to the market as necessary. The ability to adjust quickly to changes will make the difference between winning and losing.

About the Authors



Patrick Furtaw

pfurtaw@scco.com

Patrick is a Partner of SCCO International, based in Los Angeles. He has more than 15 years of experience advising senior executives on business portfolio strategy and change management processes across a broad set of industries. He is an expert in the field of value realization with a focus on market price strategies and sales management. Patrick is also a member of Pepperdine's Crest Advisory Board.



Steve Chopp

schopp@scco.com

Steve is Senior Advisor to SCCO International and an adjunct professor at Pepperdine University's Graziadio School of Business where he teaches courses on valuation and M&A. His background includes senior roles in corporate and consulting focused on helping companies drive sustainable improvements in long-term value.



John Paglia

jpaglia@pepperdine.edu

John is an associate professor of finance at Pepperdine University where he teaches corporate finance, valuation, and capital markets classes; and also directs the Pepperdine Private Capital Markets Project. An award-winning researcher, he has been quoted in *The Wall Street Journal*, *Businessweek* and on CNBC, as well as many other outlets.

SCCO International is a global management consulting firm with a focus on the simple yet far-reaching concept of consistent value management. We have been working with our clients for over 15 years to assess their business portfolios and develop and implement strategies that achieve sustainable competitive advantages and drive returns for their shareholders.

More information about SCCO International is available at <http://scco.com>. Please direct inquiries or questions to Steve Chopp at (818) 321-2376 or schopp@scco.com.

Methodology Note

To be included in the ranking, companies must be headquartered in Southern California, publicly traded for at least two years on a major U.S. stock exchange, and have minimum 2011 revenues of \$100 million. Excluded are financial institutions and real estate investment trusts. Economic profit calculations are based on SCCO International methodology. The cost of capital estimates used to calculate economic profit and value spread are based on a capital asset pricing model (CAPM) approach. Betas are based on five-year monthly total

return data and adjusted toward one consistent with Bloomberg Adjusted Beta methodology where adjusted beta = .66 x unadjusted beta + .33. Company financial information is based on actual fiscal year end data for companies with fiscal years ending between 7/1/11 and 1/31/12. Trailing twelve-month data is used for companies with fiscal years ending prior to 6/30/11. Data sources: company reports, Thomson Reuters Financial.

SCCO International CEO Performance 100 (1-50)

2011 EP Rank	2010 EP Rank	Company Name	Chief Executive Officer	CEO Since	2011 EP \$millions	1 Year EP Change \$millions	2011 Value Spread	2011 Market to Book Multiple	2011 Enterprise Value (EV)	2011 Sales \$millions	2011 Invested Capital \$millions
1	4	Occidental	Stephen Chazen	2011	3,380	1,553	7.9%	1.7x	78,604	24,119	45,564
2	1	Amgen	Kevin Sharer	2000	3,220	-537	14.0%	2.3x	54,422	15,582	23,203
3	2	Qualcomm	Dr. Paul Jacobs	2005	3,138	852	21.0%	4.3x	75,722	14,957	17,490
4	3	DirecTV	Michael White	2010	2,340	484	19.6%	3.7x	44,883	27,226	12,159
5	6	Walt Disney	Robert Iger	2005	1,213	638	2.2%	1.4x	75,280	40,893	55,470
6	8	Allergan	David Pyott	1998	625	196	11.2%	4.5x	25,369	5,419	5,677
7	7	Mattel	Bryan Stockton	2012	609	71	20.0%	3.3x	10,396	6,266	3,156
8	10	Activision	Robert Kotick	2008	607	384	8.3%	1.3x	9,908	4,755	7,502
9	5	Western Digital	John Coyne	2007	501	-670	19.9%	2.0x	4,987	9,526	2,491
10	9	Herbalife	Michael Johnson	2003	349	109	51.8%	9.1x	6,294	3,455	694
11	53	Crown Media	William Abbott	2009	284	282	45.4%	1.5x	940	323	647
12	11	Monster	Rodney Sacks	1990	275	76	171.0%	49.9x	7,483	1,703	150
13	13	Edwards Lifesciences	Michael Mussallem	2000	189	9	19.9%	7.4x	7,511	1,679	1,018
14	12	GUESS?	Paul Marciano	2007	172	-15	10.8%	2.0x	3,224	2,688	1,627
15	15	Deckers Outdoor	Angel Martinez	2005	154	18	29.9%	4.9x	3,481	1,377	712
16	16	ResMed	Dr. Peter Farrell	2011	139	20	13.4%	3.7x	4,131	1,243	1,122
17	17	Qlogic*	H. K. Desai	1996	99	-16	40.3%	4.5x	1,123	607	248
18	29	Teledyne	Dr. Robert Mehrabian	1999	97	62	8.2%	1.9x	2,459	1,942	1,271
19	14	Power-One	Richard Thompson	2008	95	-50	35.0%	0.7x	224	1,017	328
20	22	j2 Global	Nehemia Zucker	2008	83	22	21.0%	2.7x	1,126	330	413
21	25	Jacobs Engineering	Craig Martin	2006	80	24	2.3%	1.3x	5,373	10,382	4,069
22	20	Illumina	Jay Flatley	1999	74	-2	6.2%	2.7x	3,404	1,056	1,273
23	23	Cubic	Walter Zable	1951	70	12	34.8%	3.1x	783	1,285	250
24	64	International Rectifier	Oleg Khaykin	2008	69	74	8.1%	1.4x	1,384	1,177	962
25	27	Semtech	Mohan Maheswaran	2006	64	18	19.9%	4.2x	1,412	481	332
26	28	Gen-Probe	Carl Hull	2009	40	-4	5.0%	3.7x	2,680	576	723
27	24	Cymer	Robert Akins	1986	39	-18	9.3%	2.7x	1,231	594	454
28	37	Superior Industries	Steven Borick	2005	37	14	10.8%	0.8x	254	822	323
29	30	ValueClick	James Zarley	2010	34	0	5.0%	1.6x	1,408	560	865
30	73	Ceradyne	Joel Moskowitz	1983	33	49	5.8%	0.9x	522	572	590
31	32	Ensign Group	Christopher Christensen	2006	32	5	7.0%	1.5x	785	758	525
32	35	PriceSmart	Jose Laparte	2010	32	9	7.5%	4.0x	1,772	1,714	446
33	31	True Religion	Jeffrey Lubell	2003	29	-1	11.5%	3.2x	858	420	271
34	65	Volcano	R. Scott Huennekens	2002	29	34	12.3%	4.1x	1,111	344	271
35	44	Tetra Tech	Dan Batrack	2005	28	17	2.4%	1.1x	1,446	1,792	1,300
36	60	Newport	Robert Phillippy	2007	26	27	4.6%	1.1x	752	545	707
37	38	Aerovironment*	Timothy Conver	1993	25	3	28.4%	4.5x	507	320	113
38	34	WD-40	Garry Ridge	1997	24	-0	13.6%	3.4x	636	336	186
39	94	CareFusion	Kieran Gallahue	2008	21	130	0.4%	1.2x	5,864	3,528	4,794
40	84	Lions Gate*	Jon Feltheimer	2000	21	64	3.9%	2.9x	1,716	1,319	593
41	41	Korn/Ferry*	Gary Burnison	2007	17	-1	2.7%	1.4x	918	825	674
42	39	ICU Medical	Dr. George Lopez	1989	16	-3	10.3%	3.3x	453	302	136
43	42	TTM Technologies	Kenton Alder	1999	15	-3	1.2%	0.9x	1,318	1,429	1,404
44	95	Reliance Steel	David Hannah	1999	11	128	0.2%	1.0x	5,188	8,135	5,113
45	70	Reading International	James Cotter, Sr.	2000	11	26	2.4%	1.0x	441	246	438
46	55	American Vanguard	Eric Wintemute	2011	11	10	4.4%	1.7x	403	304	238
47	47	DTS	Jon Kirchner	2010	10	3	12.0%	4.4x	392	97	90
48	68	Cheesecake Factory	David Overton	1992	9	15	0.7%	1.7x	2,229	1,758	1,314
49	18	Dreamworks	Jeffrey Katzenberg	2004	8	-86	0.9%	1.3x	1,361	706	1,024
50	36	Life Technologies	Gregory Lucier	2008	8	-14	0.1%	1.2x	9,248	3,776	7,750

*Trailing twelve-month data is used for companies with fiscal years ending prior to 6/30/11.

EP = Economic Profit; Market to Book Multiple = Enterprise Value / Invested Capital

SCCO International CEO Performance 100 (51-100)

2011 EP Rank	2010 EP Rank	Company Name	Chief Executive Officer	CEO Since	2011 EP \$millions	1 Year EP Change \$millions	2011 Value Spread	2011 Market to Book Multiple	2011 Enterprise Value (EV)	2011 Sales \$millions	2011 Invested Capital \$millions
51	91	Dole	David DeLorenzo	2007	8	95	0.2%	0.9x	2,962	7,224	3,163
52	57	OSI Systems	Deepak Chopra	1987	7	7	1.9%	1.9x	746	656	385
53	48	Obagi Medical	Albert Hummel	2010	7	1	19.4%	5.0x	159	114	32
54	58	BJ's Restaurants	Jerry Deitchle	2005	5	6	1.0%	2.6x	1,482	621	569
55	54	United Online	Mark Goldston	2007	5	3	0.6%	0.7x	636	898	865
56	51	Universal Electronics	Paul Arling	2000	5	0	2.2%	1.1x	235	469	221
57	71	UTi Worldwide	Eric Kirchner	2009	3	18	0.2%	1.3x	1,911	4,914	1,423
58	45	Calavo Growers	Lecil Cole	1999	3	-8	1.8%	2.3x	363	523	157
59	46	VCA Antech	Robert Antin	1986	2	-5	0.1%	1.2x	2,806	1,485	2,329
60	52	Electro Rent*	Daniel Greenberg	1979	2	-2	0.9%	1.6x	429	246	264
61	56	National Technical*	William McGinnis	2007	-0	-1	-0.4%	0.9x	107	187	123
62	62	IRIS	Cesar Garcia	2003	-1	1	-1.0%	2.1x	148	118	70
63	72	Ixia	Atul Bhatnagar	2008	-2	14	-0.5%	2.0x	782	308	398
64	50	Overhill Farms	James Rudis	1997	-2	-7	-3.9%	1.5x	80	169	54
65	69	Hot Topic	Lisa Harper	2011	-4	8	-1.1%	1.3x	430	698	328
66	49	Wet Seal	Susan McGalla	2011	-4	-9	-1.1%	1.2x	490	620	405
67	59	Big 5 Sporting Goods	Steven Miller	2000	-6	-6	-1.3%	1.2x	554	902	470
68	63	PC Mall	Frank Khulusi	1987	-6	-2	-3.1%	0.8x	183	1,455	233
69	77	On Assignment	Peter Dameris	2004	-9	11	-2.5%	1.4x	497	597	365
70	33	Jack In The Box	Linda Lang	2005	-10	-35	-0.6%	1.5x	2,589	2,193	1,711
71	19	Ingram Micro	Alain Monie	2012	-11	-89	-0.3%	0.7x	2,501	36,329	3,833
72	67	Ducommun	Anthony Reardon	2010	-13	-7	-2.6%	0.7x	503	581	712
73	76	CalAmp*	Michael Burdick	2001	-13	6	-7.6%	0.7x	120	130	175
74	26	Nuvasive	Alexis Lukianov	1999	-14	-62	-2.3%	1.0x	698	541	688
75	75	US Auto Parts	Shane Evangelist	2007	-17	3	-19.7%	1.9x	154	327	82
76	61	MRV Communications	Barry Gorsun	2011	-17	-16	-10.3%	0.5x	74	267	157
77	74	Salem Communications	Edward Atsinger, III	1986	-20	-3	-3.2%	0.6x	373	218	626
78	78	Virco Mfg*	Robert Virtue	1990	-24	-1	-24.9%	0.8x	72	163	93
79	43	JAKKS	Stephen Berman	2010	-24	-36	-3.9%	0.5x	308	678	626
80	79	Vitesse Semiconductors	Christopher Gardner	2006	-30	-6	-9.2%	0.4x	127	141	328
81	90	American Apparel	Dov Charney	2007	-31	50	-5.2%	1.0x	586	547	577
82	83	Novatel Wireless	Peter Leparulo	2008	-31	10	-28.0%	0.3x	34	403	103
83	82	Kaiser Aluminum	Jack Hockema	2001	-33	6	-3.8%	1.2x	1,039	1,301	878
84	80	Tutor Perini	Ronald Tutor	2000	-40	-15	-2.0%	0.5x	1,192	3,716	2,270
85	40	Avery Dennison	Dean Scarborough	2005	-41	-60	-1.0%	1.2x	4,733	6,026	3,827
86	93	Quiksilver	Robert McKnight, Jr.	1991	-49	55	-2.2%	0.7x	1,544	1,953	2,311
87	81	Farmer Brothers	Mike Keown	2012	-59	-21	-26.9%	1.1x	228	464	208
88	88	DineEquity	Julia Stewart	2002	-61	4	-1.9%	1.0x	3,071	1,075	3,149
89	85	ViaSat*	Mark Dankberg	1986	-73	-23	-5.7%	1.8x	2,539	839	1,403
90	89	K-Swiss	Steven Nichols	1987	-76	4	-43.9%	0.5x	98	268	191
91	86	Powerwave Technologies	Ronald Buschur	2005	-100	-43	-12.6%	0.4x	309	444	790
92	21	Skechers	Robert Greenberg	1993	-109	-174	-8.1%	0.8x	1,096	1,606	1,311
93	66	Emulex	James McCluney	2006	-110	-104	-30.2%	1.3x	581	453	454
94	97	Ryland	Larry Nicholson	2009	-114	26	-9.1%	1.1x	1,395	891	1,225
95	96	Pacific Sunwear	Gary Schoenfeld	2009	-166	-30	-21.1%	0.6x	483	1,238	766
96	87	Callaway Golf	Oliver Brewer, III	2012	-202	-142	-33.0%	0.6x	354	887	568
97	92	KB Home	Jeffrey Mezger	2006	-209	-109	-18.6%	1.5x	1,808	1,316	1,183
98	99	Live Nation	Michael Rapino	2010	-233	61	-6.6%	1.0x	3,486	5,384	3,578
99	98	THQ*	Brian Farrell	1995	-249	-81	-76.8%	0.7x	177	771	251
100	100	Leap Wireless	S. Douglas Hutcheson	2005	-314	-8	-5.6%	0.9x	4,688	3,071	5,494

*Trailing twelve-month data is used for companies with fiscal years ending prior to 6/30/11.

EP = Economic Profit; Market to Book Multiple = Enterprise Value / Invested Capital

