

An Introduction to Colfax Corporation

by Barton Hooper

Colfax Corporation (ticker: CFX) is a multi-industrial company operating in two business segments: fabrication technologies, commonly known as welding, and gas and fluid handling. Colfax was transformed in 2012 by the acquisition of Charter Industries, which included the welding and the air and gas handling businesses, and more than doubled the revenue of the company. Colfax serves a variety of end markets, with power, oil, gas and chemicals, and infrastructure accounting for approximately 50% of revenue. The company owns several well-known industrial brands, including Howden, Victor, ESAB, Allweiler and IMO, and it is generally ranked number one or two in the product categories in which it competes.

A Rales Brothers Production

Colfax is the product of several acquisitions that began upon its founding in the 1990s by Stephen and Mitchell Rales. The original vision of the company was to purchase pump and motion control businesses. A series of transactions and divestitures over the ensuing years resulted in the two present operating businesses. The Rales brothers are known for the founding of Danaher, Inc. (a business we have long admired), on which they maintain board seats and significant holdings. Combined the Rales own approximately 18% of Colfax, and Mitchell Rales is chairman of the board. We believe the Rales brothers have proven to be excellent allocators of capital over a long period of time.

Colfax Business System

Danaher's long-term track record has been built in large part by the development of and strict adherence to what is known as the Danaher Business System. Early in CFX's development, the Rales brothers hired several former Danaher executives to build the Colfax Business System ("CBS"). The creation and maturation of CBS is a key element of our investment thesis.

In simple terms, CBS is an adaptation of the famed Toyota Production System ("TPS"), which focuses on the elimination of those activities involved in the making of a product or delivery of a service that the customer does not value—in Japanese this is known as Muda and translates to "waste". While it is impossible to eliminate all sources of Muda, it is the continuous search for it, and the improvements in quality and efficiency that result from such activities, that formed the Toyota culture. In America, TPS is generally defined by the terms "lean" or "continuous improvement," and the creation of a lean culture is the goal of CBS. While many companies claim to be lean, we often find they apply the term to temporary cost cutting measures, not as part of the development of a culture dedicated to continuous improvement. Ownership by the Rales brothers, an executive team featuring several members with a background at Danaher and along with our own fieldwork gives us confidence that CFX is building a true and enduring lean culture with CBS.

CBS will be especially helpful as Colfax continues to allocate growth capital to mergers and acquisitions. It will also enable the development of management talent to staff new acquisitions and, in turn, allow for better business integration and sales and margin improvements at acquired companies.

Short-Term Headwind, Long-Term Tailwinds

Many of Colfax's products are used to make air and water cleaner and energy intensive activities more efficient. As emerging market consumers demand that air and water quality improve, Colfax is well positioned to assist in these endeavors. Within developed markets, ever-increasing regulations to reduce or eliminate toxic emissions into the air or water will also benefit Colfax.

Approximately 45% of CFX's revenue is generated by emerging markets, which, prior to 2015, was viewed by investors as a positive. With the slowdown and outright

recession in many emerging markets and the related impact on the core industries Colfax serves, the company's exposure is now seen as a negative. We take the view that growth will return in emerging markets and at a rate greater than that of developed economies.

During this slow period, the company is using the CBS to lower costs, improve quality and develop new products. Although there is little doubt that CFX is a "cyclical" business, we believe the company competes in good categories. Combining a world class business culture (CBS) and strong capital allocation, we believe Colfax can become a cyclical compounder and long-term holding for shareowners. We estimate business value to be in the high \$30s to low \$40s, with the potential for upside depending on the timing and type of acquisitions.



Barton Hooper arrived at Weitz Investment Management, Inc. in 2007 with a passion for investing, intellectual honesty and critical thinking. His work as a research analyst gives him the opportunity to explore different companies and industries on a daily basis. He also currently co-manages the Research Fund and has since January 2008. His background includes working as a research analyst at Oak Value Capital Management in Durham, N.C., and Trilogy Capital Management in Kansas City, Mo. He also spent several years as a mergers and acquisitions investment banker at George K. Baum & Company and a CPA at Deloitte and Touche, LLC. Barton graduated from the University of Missouri with a bachelor's degree in accounting and Washington University with a master's degree in finance. He has been a CFA® charterholder since 1999.

As of June 30, 2016: Colfax Corporation represented 2.3%, 3.6%, 3.2% and 2.9% of the Partners Value, Partners III Opportunity, Research and Hickory Funds' net assets, respectively. Portfolio composition is subject to change at any time. Current and future portfolio holdings are subject to risk.

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