

UNITED TECHNOLOGIES

Added to the Dow Jones Industrial Average in 1939, United Technologies (UTX) is the 17th largest U.S. manufacturer, with a coveted first or second place market share position in most fields in which it operates. In 2008, UTX used its strong competitive advantage to generate over \$56 billion in revenues. Along with its significant market share position, UTX specializes in efficient manufacturing, and it has rather consistently generated strong margins and profits. In addition to expanding sales of existing products, its growth strategy includes buying well-known, high-market-share (but underperforming) companies, then simply running them better. The comparative persistence of above-average profits and relatively consistent operations—resulting from significant scale and powerful market share—are evidence of strong competitive advantage. In 2007, *Forbes* named UTX “The Best Managed Big Company in America.”

UTX’s portfolio of brands is made up of a wide range of businesses: elevator maker Otis; aerospace firms Pratt & Whitney (mostly jet engines), Hamilton Sunstrand (primarily aircraft avionics systems), and helicopter maker Sikorsky; HVAC manufacturer Carrier; as well as fire and security companies Kidde and Chubb. All enjoy the benefits of UTX’s expertise in making good brands even more profitable. UTX also features solid geographic diversity, with approximately 60% of revenues coming from outside the U.S.

We like businesses that stand to benefit from dominant, long-term macroeconomic trends. The emergence of higher standards of living throughout the world means greater demand for heating and cooling systems and more spending on energy, transportation and building infrastructure, which will likely benefit many of UTX’s business segments. Increasing energy costs and limits on carbon dioxide emissions make energy efficient products, such as Pratt & Whitney’s engines and Carrier’s HVAC equipment, even more competitive. Other attractive components of UTX’s business model that help provide consistency to operations include Otis’ and Pratt & Whitney’s aftermarket parts businesses (sort of a razor and razor blade approach) and a portfolio of government aerospace and defense contracts.

UTX management continues to foster a culture of cost efficiency and innovation, combined with a strategy of smart acquisitions. By “smart” we mean buying businesses that are good fits, but only at attractive prices. For example, a recent bid for Diebold, Inc. failed when UTX refused to increase its offer price. Still, UTX must have been tempted to pay more, since this seems like the sort of acquisition that has worked well for UTX. (Diebold is a well-known brand in the area of ATM’s and security systems, but it had operational problems.) Diebold’s management held out for a higher price, however, and eventually UTX withdrew its bid, calling the acquisition “attractive, but not necessary.” It may go down as a

missed opportunity, but we think it's an example of UTX's focus on balancing the long-term growth of the company with the need for disciplined capital spending.

UTX has a strong balance sheet, which significantly reduces the likelihood of unexpected capital needs going forward. Company operations generate good cash flow, and management uses this cash to pay (and increase) its dividend and to buy back stock. UTX appears to buy back stock without much regard to share price, however, which is one complaint we have. Future acquisitions will likely be funded with a combination of operating cash flow and new debt. Going forward, funds should be available at a reasonable cost, given UTX's relatively high credit ratings and low debt levels (currently about 30% of capital).

While much of the world continues to struggle economically in late 2009, we believe UTX is a company that makes what the world wants and does so better than many of its competitors. When the world is ready to grow again, we believe UTX has the right management, the products to succeed, and a global presence likely to create significant shareholder value.

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We have provided abbreviated descriptions of certain companies in order to help readers better understand the basic operations and investment considerations of these companies. Readers should note that these descriptions are not intended to be complete analyses or to be investment recommendations. Company situations are always subject to change. There are risks associated with all forms of investment, including the stocks of the companies we describe. Further, at sufficiently high prices, the stocks of even the best companies may become overpriced, and at sufficiently low prices, the stocks of even struggling companies may be underpriced.

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