ValueWalk.com Interview with Mark Foster, CFA, Chief Investment Officer of Kirr, Marbach & Company, LLC

January 23, 2012
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Mark Foster, CFA joined Kirr, Marbach & Company, LLC in 1987 and has been the firm's Chief Investment Officer since 1997. He was formerly associated with American Fletcher National Bank (now JP Morgan Chase, Indiana, NA) as a research analyst from 1980 to 1982 and with Merchants National Bank as a portfolio manager/research analyst from 1982 to 1984. From 1984 to 1987 he was associated with Merchants Investment Counseling Inc. as Director of Equity Strategy, directly responsible for managing approximately $200 million of equity assets. Mark graduated with a B.S. Finance (with Honors), from Ball State University in 1979 and has been a Chartered Financial Analyst (CFA) since 1985.

*Mark was named the "All-Cap Manager of the Year" for 2010 by Emerging Manager Monthly.

Can you tell us a little bit about your background?

I've been in the business for 32 years; the last 24 have been with Kirr, Marbach & Co. I've always had a passion for the business and a desire to compete.

Why did you decide to join KM & Co.?

I was familiar with the firm and liked the value focus. I also wanted to be in an environment where investing was the focus, not marketing or other ancillary services. In addition, having ownership and the opportunity to build a business was very appealing.

Can you tell us a little bit about your team at KM & Co?

I function as the portfolio manager and we have 3 analysts. We are all generalists, so we have the ability to look at many different companies. It's a small group, which makes it easier to move quickly on an idea and to make sure everyone is on the same page.

What inspired you to start the mutual fund?

We started our fund at the end of 1998…we clearly weren't early and it wasn't an ideal time for a value investor. Our business historically had always been separately managed accounts and we would turn away smaller accounts that didn't meet our minimum. The fund gave us an opportunity to capture those dollars and it also gave us a daily priced vehicle for the 401K and other markets.

What do you attribute your fund's long term excellent track record to?

The value focus has helped. In addition, we have an edge in terms of where we look for ideas. We are not constrained by market capitalization, and in fact we manage under an all cap umbrella. We can go wherever we find value regardless of size. Additionally, we spend a lot of time looking in areas that are less efficient. These would be spinoffs, post-reorg equities and companies with management changes. These areas are less followed and can produce some real bargains. A typical example would be a large company spins off a smaller division as a separate company. Now the management of the spin has more control over capital allocations, expansions, growth opportunities, etc. Plus they are incented based on what they produce, not on what the parent does. Additionally, the existing shareholders of the parent stock now have this small piece on the spin company and most of the time they just sell it. This temporary price pressure usually sets up a good buying opportunity.

Whose investment philosophy do you follow more; Benjamin Graham, Warren Buffett or someone else?

Well, we use a pretty plain vanilla value approach, finding stocks selling at a large discount to what the company is worth to a private buying. Nothing cutting edge here. We do think some firms like Southeastern Asset Management run their business extremely well. One of their key points is that you want to find businesses selling at a discount but you also want growing businesses….so the value of the business will compound over time. And do so at a decent rate. It's easy to identify cheap stocks. The key is finding those at an inflection point where the business is about to get better.

What is your process?

We look in those under researched areas that we discussed earlier. So each week we look at all the spins that have been announced, all the CEO changes, etc. These represent over half of our portfolio currently. We then have an analyst do some detailed work to understand the business and the key issues. We try to visit or talk by phone with each company as we are working through these issues. Our valuation work is key as we need to have a large enough discount to warrant purchase.

What are the main metrics that you look at for a company; ROIC, low PE/EBITDA, P/B etc.?

Three key areas: valuation, balance sheet and cash flows. Valuation needs to be cheap enough. This can take many forms depending on the type of company, buy usually P/E, EV/EBITDA, P/Sales are some of the standard measures we would use. We also want to pay some attention to the balance sheet. We don't mind some debt but it needs to be reasonable. Finally, we want to see good free cash flow. If you were buying the entire business you would want a business that throws off a lot off cash, not one where you have to keep funding it every few years.

How do you identify and avoid value traps?

Value traps can take many forms. It can be that the business is changing and the growth will never be what it was. Thus, there is the need to understand the changing dynamics of a business. Good examples would be Newspapers and Radio. At times they looked cheap compared to their history but they will never be what they were in terms of growth and free cash flow.

Another area is finding companies that look cheap but aren't really growing or are growing at 3-4%. They are cheap for a reason and if the business isn't growing or isn't close to that inflection point of turning then you may wait a long time. That's why we like the catalysts of CEO changes. The new guy doesn't wait around, he's brought in to make changes and get things moving

Can you discuss an investing mistake which you have made in the past?

Too many to mention in one interview. A recent one was Triquint Semiconductor. Triquint supplies parts to the mobile phone industry. Its main customer is Apple…..seems good thus far. TQNT ran into some capacity issues and basically had to tell some customers that they couldn't handle their business. These customers found other suppliers and when TQNT finished their capacity additions they thought they could recapture the business. It hasn't worked out that way thus far. So, no matter how favorable the tailwind, you still have to execute. The other issue is that these markets are changing so fast, it's hard to stay ahead.

You are currently almost fully invested. Are you usually fully invested or are you bullish on stocks currently?

We usually run pretty full. Our core competency resides in picking undervalued stocks, not in making calls on the overall market. And while we and everyone else have had to spend more time on macro issues these last few years, we don't think that's an area where we can add much value.

You have a lot of industrial and cyclical stocks; is this more of an industry specific bet or are you finding bargains in individual stocks in those sectors?

We have found many cheap names in this area. Additionally, many of these companies have streamlined their businesses over the last several years so profitability is pretty good. These companies also have above average exposure to some of the faster growing foreign markets. With the consumer working down debt levels, many of the consumer names aren't showing the top line growth that we are seeing from the industrials.

Can you tell us about why you like some of your current largest positions; Rosetta Resources, Dollar Tree etc.?

Rosetta Resources has one of the best management teams in the business. They have run much bigger companies in the past and are now growing ROSE. They have refocused the company into new developments, primarily in the Eagle Ford in Texas and are growing production at above average rates.

Dollar Tree is benefitting from the economic malaise of the last few years as customers have traded down and have actually liked the experience. These are really nice stores that represent good value. The company is small enough that they can continue to grow the store base. Additionally, they have growth opportunities in Deal$, which sells items for more than $1, and Dollar Giant, a Canadian retailer. We like to see companies that have multiple growth drivers.

What type of catalysts do you look for?

As we mentioned before, we look at spins, post reorg, CEO changes. These tend to be pretty good catalysts in and of themselves. We also spend some time trying to understand what expectations are built into stocks and where we might differ from consensus. This can lead to earnings surprises which are excellent catalysts

What are some of the special situations you like to invest in?

We mentioned before some of the areas we invest in. A few specific examples would be Ascent Capital Group. This was a spinout from Discovery Holdings back in 2008. At the time it was selling at a discount to the cash on the balance sheet. At the same time it was cash flow positive. Management has since reoriented the business into the security alarm monitoring business and the stock is still cheap.

LyondellBasell was a company that came out of bankruptcy in 2010. Great management team, strong business with lots of free cash flow. They have paid down all their debt and have some very attractive growth opportunities.

You look at the $1-$10 billion market cap range. A lot of value investors are finding value in large caps now. Are you still finding value in the $1-$10 billion range? And are you finding value in large caps?

We find a lot of cheap stocks in the large cap area but we also find muted growth rates for many of these companies. Again, we want to see cheap valuations but we also want to own growing businesses. We are currently 10% small cap, 55% mid cap and 35% large caps. We will go where ever we find value and compelling fundamentals.

Thank you for your time!