INSTITUTIONAL APPROACH

Invest with wholesale prices, get brand name returns

One institutional manager finds growth by turning to the companies household names depend on

by **Jessica Bruno**, *content editor of Advisor Group.*

When Robert Beauregard and his partners founded Global Alpha Capital Management in 2008, all they had was one major client—and faith their small-cap stock picking would pay off.

Their portfolio was down 30% by the time the market hit bottom in March 2009. But their main account, Connor, Clark and Lunn Financial Group's private client division, stuck with them.

Since 2008, the CC&L Global Alpha Fund has returned 14.1%. Meanwhile, its benchmark, the MSCI World Small Cap Index, returned 11.2%, says Beauregard.

The company now manages money for the International Brotherhood of Electrical Workers, New York State employees, the Hail Foundation and private clients. Beauregard is CIO.

Global Alpha's AUM is about $200 million, and Beauregard says the company has room to grow.

It focuses exclusively on global small-cap portfolio management. And it has capacity for up to $4.5 billion in assets, he says.

Global Alpha focuses on 23 developed markets, including Europe, Hong Kong, Singapore, Australia, New Zealand, the U.S. and Canada. We spoke to Beauregard about his approach.

> *We look at big industries that have many years of growth ahead, such as transportation or health care.*

Q: How is your global small-cap focus unique?

Your typical Canadian small cap would be $500 million, and most of those companies would be resource-focused. In that space, it becomes a top-down call on resources, and stock picking would almost be a secondary decision.

In global small cap, it's more diverse and the average company is much bigger, with market capitalizations of about $1.5 billion.

The biggest industry makes up about 7% of the global small-cap market. For global small-cap stock pickers, no single stock is a big weight in an index, so you can concentrate on choosing companies you really want to put in the fund—as opposed to worrying about some company being a big weight in the index and hurting your performance if you don't want it, or are uncomfortable with that company.

Q: Could you tell me about a small-cap stock you hold?

We've owned Autogrill, an Italian food services company, since 2008. If you've traveled to Europe, you've probably stopped at an Autogrill in France or on an Italian highway. People don't know they are clients in Canada too. They run food and beverage outlets at

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Pearson Airport, and they have restaurants at most major Canadian airports, including Ottawa, Edmonton and Winnipeg. Two years ago, they signed a 50-year contract with the Government of Ontario to have every highway service area in Ontario. They're a small-cap name with $7 billion in annual revenues—illustrating the difference between Canadian and global small caps.

When we buy these companies, they've often just gone through an investment phase, and are transitioning between two growth phases. Often, the market doesn't want to be there during those transitions, or it's waiting for confirmation that growth will resume. Our average holding period is about five years, and because of our long-term focus, we will often buy in advance of that confirmation. Despite strong markets, until the early part of 2013, Autogrill had underperformed. But we're comfortable with the strategy. The company split in two last fall and we received shares of both entities. In the last year, our original investment has doubled.

We look at big industries that have many years of growth ahead, such as transportation or health care. Then we find companies that will grow faster than their industries, and have better than usual balance-sheet management. Typically, our companies will have no debt, or less debt than their peers, reducing risk of bankruptcy or financial crises.

Q: How is Autogrill suited to institutional clients?

Institutions have been attracted to infrastructure. Looking at multiples, like the enterprise value-to-EBITDA ratio that are paid for airports, they're expensive. When a Canadian pension fund bought a stake in Heathrow Airport Holdings recently, they paid 13 times EV to EBITDA. We paid 6.5 times EV to EBITDA for Autogrill. When you buy Autogrill, you buy the company that manages all the space inside the airport. They operate stores like Starbucks and Tim Hortons. It has the same kind of long-term profile as an airport, with 50- or 20-year leases, but it has a much lower valuation and probably less regulatory scrutiny. In another example, the Ontario government would probably intervene if the owner of Highway 407 decided to charge $10 per km, whereas if Autogrill decides to charge $6 for a coffee, no one could say not to.

Q: You arrange your investments around themes. How does that work?

We're trying to identify trends or themes that will create long-term dynamics in the economy. For example, environmental and alternative energy companies present good investment opportunities. Another trend is demographics. We often talk about the aging population, but we try to take a broad view. Western populations are mostly aging, but a lot of emerging countries' populations are doing the opposite.

Even in the U.S., the echo-boom generation is actually larger than the baby boomers. There are 80 million echo boomers versus 78 million boomers. You could have an investment strategy targeting people between 20 and 35 years old by anticipating what they'll be buying. For instance, companies that focus on weddings and furniture would be good picks, since many people in that age group are getting married or buying homes.

Q: How do the themes affect when you sell a stock?

A theme change wouldn't bring us to sell an investment. We may sell a company when it reaches a $5-billion market-cap. We want to offer our clients a different exposure than what they get from their large-cap managers. We're a true small-cap fund, and we believe that, by that milestone, we should have more than tripled our investment. Looking at the number of companies that go from $500 million to $5 billion, there are about 20 times more than those that go from $5 billion to $50 billion, for example. Your chances of picking a company that will give you a return on capital of 10 times are much higher in our space than in the large-cap space.

Q: Do you seek uncorrelated assets to balance your themes?

The last few crises have shown us that there's nothing that isn't cyclical. But the trends we follow are strong, and companies that they positively affect have rebounded much more quickly than others.

The high volatility is in raw materials or natural resources, and we have little of that in our portfolio; metals, for example, are about 3%, and gold is 1%.

Because these are small companies, most can still grow even if the economy isn't growing. For instance, few people have heard of Stella International, but they make shoes for some of the largest companies. It's a Stella product whether you wear UGG or Sorel boots in the winter, or Merrell if you like to go hiking, or Marc Jacobs if you go out. They make 50 million pairs each year, and market demand is 1.5 billion pairs of shoes a year. For a company like Stella, even if the economy were to slow down, gaining an additional 1% of market share is 15 million pairs of shoes, or 30% growth for the company.

Q: How do you assure clients that, by investing in global small cap, they're not missing out on other opportunities?

In the U.S. and globally, some asset strategists recommend having as much as 12% of the equity portion of a portfolio in global small cap. I don't think small cap should replace other investments, but it really helps investors' diversification. AER

COMPANY STATS

Autogrill SpA
Symbol: AGL
Listed: Borsa Italiana
Price August 2008: €3.50
Price September 2014: €6.45
Founded: 1947, in Italy
What: Food and beverage services company, with highway, airport and railway station locations
Where: Europe, North America and Asia

Stella International Holdings
Symbol: 1836
Listed: Hong Kong Stock Exchange
Price August 2008: HK$13.50
Price September 2014: HK$19.30
Founded: 1982, in Taiwan
What: Footwear designer, manufacturer and retailer. Makes shoes for companies like Prada, Sorel and ECCO
Where: Factories in Taiwan, China and Vietnam

Note: Investment statistics as at September 15, 2014.
Sources: Autogrill, Borsa Italiana, Reuters and Stella International Holdings.

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ACTION STEP

Look for firms that support brand-name companies as potential investments.