

## **Star Gazer Cliff Greenberg – Portfolio Manager of the Baron Small Cap Fund**

Cliff has been the Portfolio Manager of the \$2.8 billion Baron Small Cap fund since 1997 where he invests in classic growth companies, fallen angels and special situations. He had an impressive performance versus his peers: Baron Small Cap has outperformed 90% of the funds in the small-cap growth universe over the past five years.

[start box] “I am interested in businesses that I understand, people who I respect, and an opportunity as their shareholders make big returns over a long period of time.

A lot of how I invest is based on the people who run these companies. My approach is to be a long-term owner of a business, or long-term shareholder, and assume the role of an owner. I believe that the managements of the companies I invest in are my partners. I need to get to know them, and get to respect them, and I want to believe in their vision. To do that, before I meet with them for the first time, understand their background, and try to learn as much about the people as I can based on their prior experience. Then I get to have one on one meetings with the senior executives of the companies I'm interested in investing in, to better get to know who they are and understand the company from their perspective, understand the opportunity from their perspective, and ask the questions that I think are most important to the future of that business. This helps me assess how I can make big returns to shareholders. Through that whole process, I can take the measure of these people and hold an opinion, and very often those opinions change. I might think someone is very interesting or terrific the first time I meet them and then their actions are inconsistent with what they say. Or, just the opposite, people who you might meet at first and think are good operators can really turn out to be fantastic operators. I assess people by spending time with them, a lot of time with them, and time with them not just when we buy a stock, but over the years that I own a stock, and since I own stock for periods of five or ten years if I think I can make big returns as their shareholders, I can assess them over this whole period of time.

What I'm looking for in companies is the opportunity to make big returns as their shareholders. The best way to do that is to find unique companies with big opportunities that have defensible niches and have entrepreneurial managements and cultures that can take a little idea, a little company, and turn it into a big company.

I supplement that classic growth investing with what we consider special situation investing where I buy growth companies that in essence are spun out from some other enterprise and because, as opposed to being IPO's, they're spun out and usually are obscure and hard to find, I can buy them real cheap and I like to buy recapped, so I like to buy growth companies that somehow get messed up either their capitalizations are screwed up or they don't grow to expectation.

I try to invest in the same industries year in and year out, and by doing so you become cognizant of a lot of companies in that same business and therefore, things kind of occur to you as an investor because of where you've invested before. I also am anxious to find new companies, public offerings, very often these are very small companies that are just fresh to the public market and can meet that first criteria of being big growth opportunities and even though they're not seasoned as public companies, we believe we can get our hands around them, understand their business, and that's a real good time to get involved.

We've made big returns in multiple ways. The fund that I presently run has been in existence for about 8 years. Throughout that entire period, I've owned some stocks from then to now and have made tremendous returns just by investing in small companies and holding the stock for a long period of time and have prospered as they got bigger and their earnings grew and their multiples expanded. An example of that is Iron Mountain, a stock I've owned for this whole period of time. In the 8 years I've owned it its revenues have gone from approx \$200m to \$2b and the stock's up about 5 fold. Choicepoint, was a spinout, a similar company that I have also owned for 8 years. Its revenues have gone from about \$300m to about a billion dollars and its stock is up 5 fold. Iron Mountain is a very simple idea that has just executed over time. By being participants with a really good management team that is a fantastic executor of a relatively simple business, and then a very good strategic operator in how they've gone about capitalizing on these other opportunities.

I try to look at most all situations where companies are separated from their parent, very often you can buy those neat, growthy businesses at cheap prices because as opposed to being marketed like an IPO with a lot of fanfare, these companies get to the public markets kind of under the radar screen and therefore as the stocks are distributed to the holders of the parent company, very often those holders are

sellers because they don't know what they own and I can buy a stock very cheaply. This is because there's more for sale than there are people knowing to buy it, kind of opposite of the IPO process. Very often you can find great companies there that can turn out to be growth companies just like a new IPO, so most recent, or biggest success we've had recently is something called Brookfield Homes, a CA-based homebuilder growing very rapidly because it has large land holdings in SF and in Washington, D.C. that are moving from being rural land to being developed and homes are being built on them, so therefore earnings are growing dramatically.

Most often the mistakes I'm making are in misjudging management. I thought these people could execute these novel business ideas I'm investing in, but present management, you know, sometimes they're not up to the task. I've had my share of investing in people who turned out to be crooked, and who were in essence lying in financials and misrepresenting what was going on in their business, and misrepresenting that to me. So, as I look through my losers, that's been the common theme. Not that the game plan wasn't interesting, but in execution of the game plan.

Picking stocks or investing is kind of like dating; at first, when I meet these companies, it's easy to get enamored, and your mind immediately starts going to the future of what this company can become and how much money I can make as being a shareholder of it. Then probably 3-6 months into owning a company is where the blemishes start coming out and you start to realize more and more what the obstacles are to achieving the success and what the risks are along the way and what the foibles of the people might be. It probably takes about a year or so for me until I really truly can say that I understand the business well. So, to me it takes time for me to really develop that conviction that I've got a winner, even though you're so jazzed when you're buying it in the first place that you're sure you do.

My approach has been to take a longer-term perspective than most and I think that works. Sometimes if a stock doesn't perform immediately and/or if you expect a business to grow dramatically yet it has an immediate or short-term or there's periods over its life where it really doesn't, it's very easy to get frustrated and to lose your courage or lose your conviction and to me that's the wrong response. So the right response is to go back and make sure that what you believe you can still believe. If you do, but the stock isn't performing, or the company has a quarter or two where the earnings don't grow as dramatically as you expected, but in your conversations with the company and your thinking about the business, you believe that's just temporary, very often what I do in those periods of time is look myself in the mirror, say, do I still believe? If I do, and the stock is down, which very often it is during those periods of time, as opposed to getting frustrated and selling and saying I screwed up, very often I'm doing just the opposite, which is purchasing more stock if I still believe long-term that I have a real winner. That effort, of not being affected, not letting the market mess with how you're thinking about your opportunity to make money in the stock and not letting a quarter or two affect your impression about the long-term prospects for a business, and actually benefiting or playing against the fact that others are going to be anxious and nervous and sellers during that time, that's one of the reason I think we've had success is that you can stand up to your conviction at that period of time and very often increase that position when others think the growth is over." [end box]