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An alternative path to growth

The son of the founder of Gabelli Asset Management has been the driving force behind much of the company's recent success. BY PAUL TAYLOR

Marc Gabelli: man with a mission to earn a superior return for clients by picking stocks'

The walls surrounding Gabelli Asset Management's trading floor in Rye, New York, are hung with pictures of corporate leaders such as Sumner Redstone of Viacom, John Malone of Liberty Media, Charles Lee of GTE and Rand Araskog of ITT.

They are all former recipients of an annual Gabelli award to senior managers who have made outstanding contributions to shareholder value, explains Marc Gabelli whose father, Mario, founded the company 25 years ago "to earn a superior return for clients through picking stocks".

This mission, says Gabelli, has not changed. But the size of the business and the range of products offered to its institutional, high net worth and mutual fund customers, have grown dramatically. The group now has more than $26bn under management.

Institutional and high net worth portfolios - split into separate accounts and hedge funds - comprise about 60 per cent of the assets. Mutual funds, traded under the Gabelli, Comstock and Westwood brands, make up the balance.

While Mario Gabelli is closely associated with the group's mutual fund products, much of the growth has been driven by its alternative investment products and by his son, Marc Gabelli. "We are research-driven fundamental investors focusing on 'value with a catalyst' investing," says the younger Gabelli. The strategy draws on the value-investing principles of Benjamin Graham and David Dodd, adapted by Mario Gabelli who developed private market value analysis that underpins Gabelli's stock picks.

Marc Gabelli applied this strategy to international equities and led the group's expansion as portfolio manager for the top-rated Gabelli Global Growth mutual fund. He explains that investors "want regional funds because that is how they allocate capital".

But some client aspirations are difficult to satisfy. "Everyone wants an arbitrage fund for Europe but the problem is that you don't have a set takeover code across Europe. Because of that you can't, as an arbitrageur, quantify all the variables and risks so we are not going to start a fund in that environment." Instead, he says the company is focusing on "pre-arb opportunities" and "great stocks that are mismanaged or undervalued".

"That's where the hedge fund came into it," he says. "After we went public [in 1999] we raised money for growth and we changed the corporate structure. We started to expand the hedge fund areas and we will probably grow more in that area because hedge funds are becoming more institutionally accepted."

Gabelli believes that, backed by legislative changes, the mutual fund and hedge fund industries will gradually merge. "I think that will be very good for the industry, and for us," he says. "We are not trying to lever five to one and buy futures on Indonesia - we are picking stocks. Why shouldn't we have a product focused on absolute returns using our stock-picking ability?"

He describes the group's hedge funds as "pretty plain vanilla". He adds: "We are obviously long and short, but that's a tactic. Our strategy is looking at value with a catalyst."

Typically Gabelli's research team uses two main methodologies to assess stocks. The first step is usually to isolate the core business and working out its cash flow, "the best barometer of a businesses' value".

Gabelli, who says he pays little attention to traditional price/earnings ratios, illustrates this technique by highlighting one of his favorite portfolio stocks, Vivendi, the French media conglomerate. Gabelli's analysis "showed that it was the cheapest entertainment business in the world on a consolidated cash-flow basis".

The second rule, what Gabelli calls "the crux of the Gabelli process", is to calculate a company's private market value. Essentially this represents the strategic premium above intrinsic value placed on a business - or how much an informed trade buyer would pay for it.

"We try to find companies trading at large differences to their private market value in the public market. In Vivendi's case, for example, the analysis showed the company was trading at a 50 per cent discount to a private market value in 2003 of about $95 to $100 a share. It's cheap on a cash-flow multiple basis and private value basis."

However, he emphasizes that Gabelli does not buy stocks just because they are cheap. "You need to have a catalyst in place for us to take a position," he says. That catalyst could be regulatory or management changes to accounting rules or factors such as sector consolidation, divestitures or stock buy backs.

Typically Gabelli is looking for a catalyst to kick in within two to three years, or, in the case of hedge funds, within about 12 months. "We generally don't get involved in a lot of lawsuits. We will publicly talk about values and bad management but we don't generally take people to court." ■