

ELECTRONIC Q&A

A Stock Generalist Gets Specific

By TERESA RIVAS

A value-fund manager shares some “steady-eddie” stocks that he thinks have room to run.

MANY STOCKS HAVE ALREADY run up in the wake of signs that the economy has begun to recover.

Kent Croft's goal is finding those stocks that haven't joined in yet.

Croft is the chief investment officer of Croft Funds and portfolio manager of the Croft Value Fund (ticker: CLVFX), a large-cap value fund that ranks in the top 10th percentile for one-, three-, five- and 10-year periods and earns a four-star rating from Morningstar.

Croft says his success stems from being a generalist and his firm's commitment to being a “repository and originator of unique ideas.” Currently, he thinks that despite the market's rally in the past year, there are a number of stocks that have room to run, especially when investors take a long-term perspective.

His biggest bet is in energy. He also sees opportunities in technology and health care, even though they are not normally ground on which value investors dare tread.

Below are excerpts from his conversation with Barrons.com.

Barrons.com: What stocks are you excited about today?

Croft: Diversification is as important as ever. We do own those names that have had some of the best rebounds from the lows of last March. But I think you need to continue to have some of that exposure to the global economic turnaround. Some of the newer names that we have been finding have been sort of the more

steady-eddie companies—they haven't participated in the rebound as much, but you get very high quality franchises at really good entry points for the long term.

I'll give you an example: General Cable (BGC). Here is a company that makes transmissions, wire and cable for electric utilities for the grid and also makes products for fiberoptics, communication cables and [similar equipment]. This is a company that had a good long-term strategic acquisition of Phelps Dodge's business. So they brought on some more debt and there were worries. But they announced in the middle of March that they were going to be buying back \$100 million worth of stock. We don't always go along with stock buybacks with companies, but we doubled up on our position. So that's one stock that has obviously done well, doubling since then. And it is one we still like. We are adding to it as we have funds. And it is still right for us, trading at 11 or 12 times earnings with a pretty decent long-term growth rate.

There are a number of well-known large-caps in your fund.

I'll highlight three on the bigger side and why we like them. First, though not typical [of] value [investing], is Cisco Systems (CSCO). It is a company that we believe has all the right products for a modern global economy. With the increased broadband usage over time, which is a very visible phenomenon unfolding over many years, Cisco is just at the heart of benefiting from that. And you are paying

Manager's Bio



Name: Kent Croft
Title: Chief investment officer, portfolio manager
Age: 46
Education: AB in English literature, Dartmouth College

Hobbies: Reading fiction, hunting, fishing, bird-watching, hiking

15 or 16 times earnings. They are never going to grow like they did back in the [tech] bubble times. But you certainly aren't paying bubble multiples for a best-in-class type of franchise with good visibility, and that's why we like that. It is not a typical value name. But to us it is a value given the area that they are in relative to the growth rate.

Baxter International (BAX) is another new name for us. Because there is so much uncertainty over health-care reform still, and it weighed on the stock, that peaked our interest. Here is a company that has the premier global franchise in regards to blood and fluid as it relates to the [human] body. Yet you're only paying 12 or 13 times next year's earnings, and we think at least a low-teens growth rate, for a premier global franchise. And 60% of its business is international, so it is not going to be affected by U.S. health-care reform anyway.

One other I'll mention is home-retailer Lowe's (LOW). You are paying maybe 17

(over please)

Fund Facts

Assets:	\$183 million
Expense Ratio:	1.46%
Front Load:	None
Annual Portfolio Turnover:	15.5%
Yield:	0.11%

Source: Morningstar

Top 10 Holdings

(as of Dec. 31, 2009)

Petrobank Energy & Resources	PBEGF
Ace	ACE
Weyerhaeuser	WY
Freeport-McMoRan Copper & Gold	FCX
FMC	FMC
Foster Wheeler	FWLT
Johnson & Johnson	JNJ
Invesco	IVZ
Lowe's	LOW
MetLife	MET

Source: Morningstar

times next year's earnings, so not really cheap. But this is a company that has increased their earnings potential over time because they are the best in the business. They were able to pick up three points in market share during the downturn. So coming out [of the recession] as housing unfolds over the next few years, we see potential of better earnings than they've even had prior to this.

General Electric (GE) was another larger name I saw in your portfolio.

Again, it is not going to have the growth rates it used to. But I think from this [stock] price forward, looking out over the next couple of years with the [economic] turnaround, some of their global mega-cycle energy projects will turn around, so you are getting GE for a reasonable price. And I also think they're looking to get their dividend back up.

Is Petrobank Energy & Resources (PBEGF) still your top holding?

It is still our largest holding. We bought it back when it was a half a billion dollar market cap, and today it is about a \$5 billion market cap. It is Canadian and primarily trades in Toronto, but there is an ADR [American depositary receipt]. We got attracted to it based on their assets in the oil sands in Canada. But as we dug deeper, we discovered that they had this very wonderful and unique proprietary technology for heavy oil extraction. It is called a Thai process. Basically it can reduce environmental impact by not using really any water in the process, also not using much energy itself. So it lowers cost and in some cases has doubled recoverability of the reserves. This is a process that they are starting to license now, and it could be very important. They're also great explorers. They've got great as-

sets in the some of the better oil plays in North America right now. They've also created value in Colombia through their subsidiary, Petrominerales. They ended up taking it public, but they still own 80% of it. It has been a great performer as well. It is one that we started buying between \$3 and \$4 and it is \$50 today, and we still like it.

You don't have many financials, but Bank of America (BAC) is one you own.

I would say we were lucky not to be too exposed to financials. We stayed away mostly because we just didn't feel like we could analyze things, and we weren't comfortable with it. We've added to Bank of America, and we think it will continue to be viable. It is never going to be what it was. But it is still a good company. It has a lot of assets that I think, as things become normal over time, certainly calls for a somewhat higher valuation.

Thank you.

Investment Philosophy

Croft is a long-term value-oriented generalist who likes a contrarian bet. He is a bottom-up stockpicker who looks for companies that Wall Street has given up on, or that have future catalysts that others have not yet noticed.