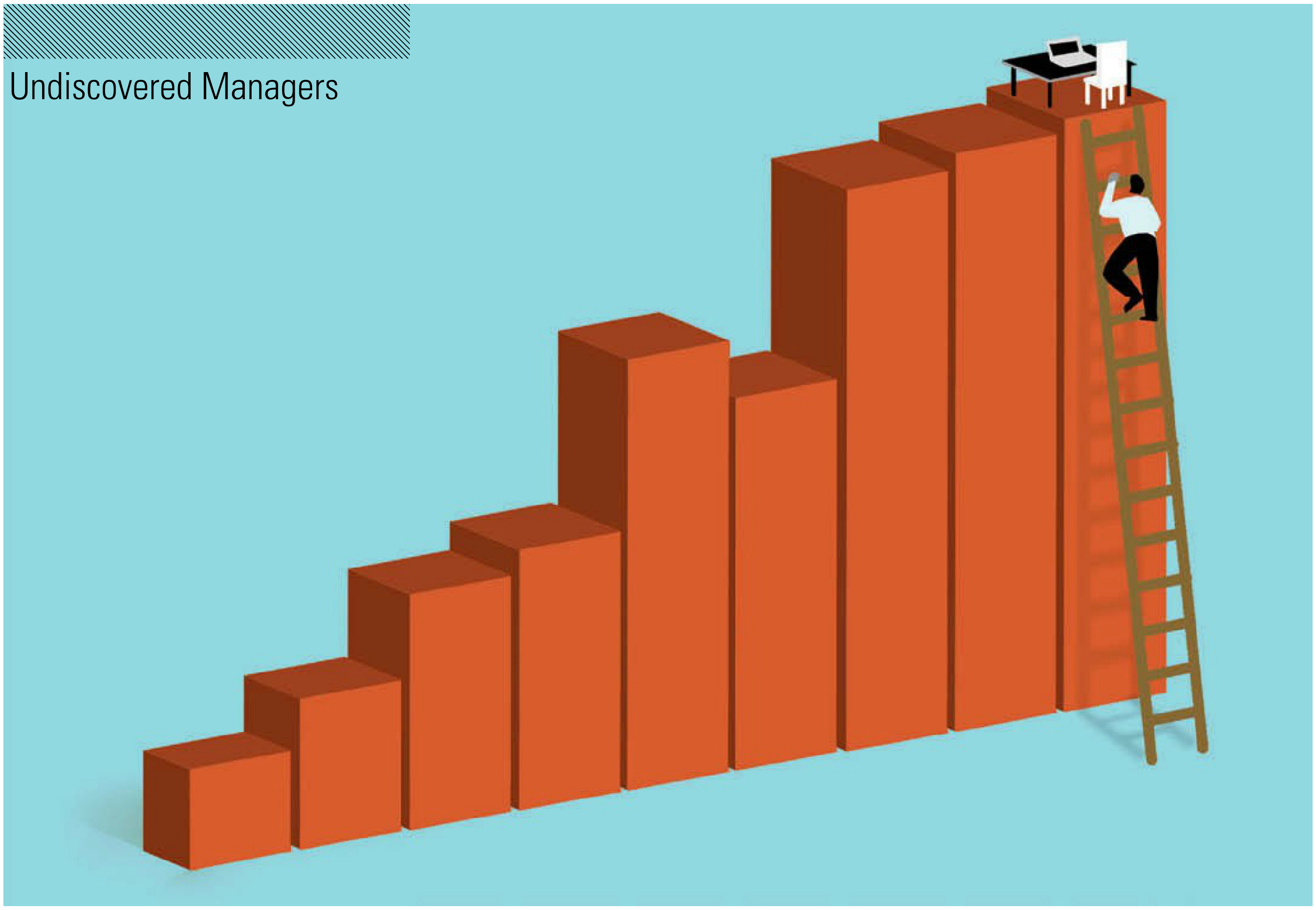


Smooth Transitions

By Rob Wherry

These managers have planned for the future—and protected strong records—by placing an emphasis on succession planning.

For many investors, the initial appeal of investing with a manager at a small fund company centers on details that have little to do with performance or fees. It's the idea a manager can run a unique strategy with a long-term focus free from external pressures. It's the fact a relatively small asset base allows a manager to be more nimble when reacting to changes in the stock market. It also helps that in many cases the manager's name is securely affixed to the front door, a sign that even if the manager does indeed knock it out of the park, he or she won't leave for greener pastures.

But building such a distinct corporate culture means those same small fund companies must take extra precautions to ensure the firms continue after their founders head into retirement. In its most sensible form, succession planning entails a founder surrounding him- or herself with people who have the same integrity and ethics as he or she does and who will be able to lead a fund or the firm well into the future.

"Succession planning is definitely a factor," says Brian Merrill, a principal at Tanglewood Wealth Management in Houston. "We invest in a lot of boutiques. We want a company that has a strong identity to go along with the process. We don't care if it's a father handing off to a son, as long as that previous manager has ingratiated into the new one the philosophy, culture, and process."

The mutual fund world has its fair share of fund companies that got succession right and those that have stumbled when handling it. For example, Morningstar recently reduced its rating to Silver from Gold for Westport WPFRX and to Bronze from Silver for Westport Select Cap WPSRX because longtime managers Andy Knuth, 75, and Ed Nicklin, 67, haven't named a successor. PIMCO's recent problems with succession have spilled onto the pages of *The Wall Street Journal*.

At the other end of the spectrum are firms such as Davis Advisors, parent to the Davis Funds and a firm that has transitioned through different generations of its namesake family. Add to that list Becker Capital Management and C.H. Dean. The two firms have quietly built solid records at their respective flagship funds, Becker Value Equity BVEFX and Dean Small Cap Value DASCX, even as they have gone through changes. While both of these funds have hit some obstacles along the way, they offer glimpses into how succession planning can be successful if handled correctly.

Father (and Son) Knows Best

Pat Becker Sr. was a successful broker at Dean Witter when he decided to open his namesake firm in 1976 that focused on running money for clients in its hometown of Portland, Ore., mostly through separate accounts. The Becker Value Equity fund was launched in 2003 and recently crossed its 10-year anniversary in the top 10% of the large-value category.

In the 2000s, Becker Sr. wanted to find a smart way to ensure the future of the firm he had built. Finding good help wasn't a problem. The fund's investment team features nine portfolio managers and analysts who average 18 years at the firm. One obstacle, though, was cashing out Becker Sr.'s ownership stake. The firm was familiar with some of the standard options: sell the business outright to an outside investor or take on debt, the proceeds of which could be used to pay Becker Sr.

"Over the years, we had those options," says Scott Herrick, head of national marketing for the firm. "But we had enough of a belief in what we had built. We didn't need to look outside the firm to find the money." Indeed, three employees, including Patrick Becker Jr., purchased Sr.'s ownership stake in the firm. Now, as a way to incentivize the staff, the firm allows most tenured employees the opportunity to buy shares when they become available.

Becker Sr. also constructed a flexible management structure that could easily carry on without him. For example, five comanagers—Marian Kessler, Michael McGarr, Stephen Laveson, Andy Murray, and Robert Schaeffer—control the buy-and sell decisions at the fund, but they also serve as generalists, splitting equity research roles with four analysts.

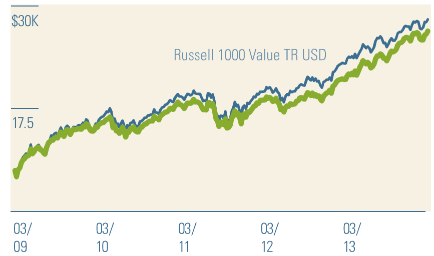
"This is a very non-hierarchal firm," McGarr says. "There aren't layers of bureaucracy and decision-making we have to go through."

The fund's investment team tries to determine between stocks that are experiencing a short-term stumble and those that are succumbing to more serious problems. They focus on solid balance sheets and earnings growth that is stable or improving. They then assess valuation by looking at price/earnings, price/book, and enterprise/EBITDA ratios. Ultimately, they build an equal-weighted portfolio of 50 to 60 stocks and consider selling when those positions reach a price target or drop 15%.

In mid-2013, the managers began moving out of some high dividend-paying stocks in favor of more economically sensitive (and cheaper) companies. The move largely paid off as stocks such as Johnson Controls JCI propelled the fund to a 28.1% gain the past 12 months through Feb. 28, which is almost five percentage points ahead of the large-value peer group average. New positions include Amdocs DOX, Tesco TESO, and Plum Creek Timber PCL. Amdocs sells the software that allows cable companies to bill its customers, a sticky business once the contract is won. (AT&T T is its largest customer.) Tesco is Britain's largest supermarket chain and has been overcoming some execution problems. The managers like Plum Creek as a play on the recovering housing market. Those positions were largely funded by

Schaeffer, Kessler, McGarr, Laveson

Becker Value Equity BVEFX

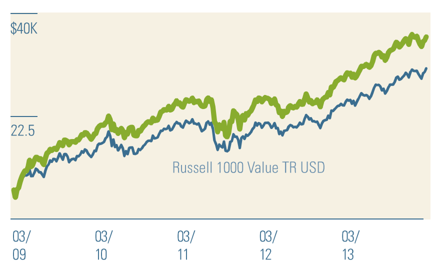


Category Large Value	**Expense Ratio** (%) 0.93
Morningstar Rating ★★★★★	**5-Yr Annl Total Rtn** (%) 24.1
Minimum Investment $2,500	**5-Yr Total Rtn % Rank Cat** 35

Data as of Feb. 28, 2014.

Steven Roth

Dean Small Cap Value DASCX



Category Small Value	**Expense Ratio** (%) 1.25
Morningstar Rating ★★★	**5-Yr Annl Total Rtn** (%) 33.2
Minimum Investment $1,000	**5-Yr Total Rtn % Rank Cat** 16

Data as of Feb. 28, 2014.

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Angela Brill

trimming stakes in some of the dividend-paying and cyclical names that had performed well including Johnson Controls, Southwest LUV, Merck MRK, and Raytheon RTN.

Finding the Right Fit

"You can plan your succession or the world will plan it for you," says Stephen Miller, president of C.H. Dean, a wealth management firm in Beavercreek, Ohio.

In the mid-2000s, C.H. Dean was heading into its fifth decade of existence. Since being founded in the 1960s, the firm had grown from managing money for a few physicians into a full-service investment firm that runs $735 million, including the Dean Small Cap Value fund, which was launched in 1997.

Miller was concerned about positioning the firm for future decades. In particular, he was disappointed with the performance of the small-cap strategy, which was causing it to languish in a sea of competitors. Miller decided that in order for the fund to survive—and thrive—it needed new management that would not only commit to the fund but to the firm, too.

"I wanted to find skilled portfolio managers that also wanted to be [firm] owners," Miller says.

Miller found what he was looking for at American Century. Over the course of two years, he hired away managers Steven Roth, Douglas Leach, and Kevin Laub, and also Patrick Krumm, who handled client services. The team, who Miller allowed to remain in a suburb of Kansas City, had been successful focusing on what they consider high-quality companies trading at a discount to intrinsic value. (Laub and Roth were part of a small cap value team at American Century; Leach was senior analyst on an all-cap value eam.) Their perception of quality is formed by sturdy balance sheets, stable returns, high free cash flows and return on capital, and a dividend yield.

"You could see from their history at American Century that these guys had a good record that just wasn't showing up on the screen," says Angela Brill, a financial advisor and portfolio team director with Prosperity Advisory Group in Overland Park, Kan. "I was able to look past the idea there was a change in management."

Roth and team aren't afraid to position the fund in contrast to the Russell 2000 Value Index. For example, one of the fund's best performers last year was Arris Group ARRS. The managers have been taking profits in this position as the shares have doubled on the successful acquisition of Motorola Home, which it bought from Google GOOG, and stronger sales of its set-top cable boxes. The fund also did well with Select Medical Holdings SEM, a firm that owns specialty hospitals and rehabilitation centers. Its shares shot up more than 25% in the fourth quarter of 2013 after a bill proposed to push out five-year reimbursement cuts to long-term care facilities. Both are considerable overweight positions.

While those stocks provided tailwinds, an overweight to the materials sector countered those gains. For example, the team initially trimmed its position in Schweitzer-Mauduit International SWM, which makes paper for the tobacco industry, shortly before the company missed fourth-quarter earnings estimates. Roth, though, added back those shares as the price dropped more than 20% since then. While Roth doesn't consider himself a rapid trader, the fund's turnover has average 169% over the last five years as he has moved in and out of positions. The category average sits at a current 83%.

It's been five-plus years since Miller made the decision to bring on new management. There are signs his decision has paid off. Roth and team have struggled during their tenure in some down markets, especially during the third quarter of 2011 when the portfolio was largely affected by macro issues in the United States and Europe. But the fund's annualized 33.2% return the past five years through Feb. 6, 2014, is four and three percentage points ahead of the Russell 2000 Value Index and the small-cap value peer group, respectively. In addition, Roth has more than $1 million of his own money in the fund, a level of conviction not normally found with small-cap managers.

"They eat their own cooking," says Brill. "That was a big deal for me."

The fund now holds $136 million and Leach and Laub are focusing on the firm's mid- and large-cap strategies, respectively. It wouldn't be a surprise to see the team add analysts.

"We have raised our game," Miller says.

Rob Wherry is the associate editor of Morningstar magazine.