

# MONTREAL BUSINESS MAGAZINE



John Dobson, Founder and Chairman



Randall W. Kelly, President

**Formula Growth Fund**  
1960 40<sup>TH</sup> ANNIVERSARY 2000

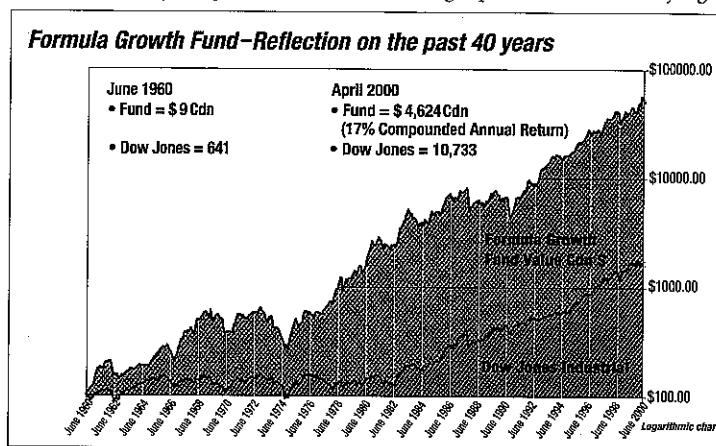
# Winning Formula

Relentlessly focused on its methodology, this fund has outperformed with consistency

BY MICHAEL CARIN

**E**arlier this summer a group of well contented investors met in Montreal to raise their glasses and reflect on their good fortune. They were the unitholders of the Formula Growth Fund, observing the Fund's fortieth anniversary. Perhaps more than anything else, the event served to highlight the success of a portfolio strategy that has concentrated its attention exclusively on emerging growth stocks in the United States.

In essence, Formula Growth Fund began as an investing club. A group of friends got together in 1960 with starting capital of \$134,000.



The club soon evolved into the equivalent of a private mutual fund. Over the years numerous friends and family of the original members joined in. Now the Fund accepts new investors only at the rate that former ones depart. (The membership attrition has been about 1% a year for the last fifteen years.) Approximately 800 unitholders today have \$500 million invested.

The *modus operandi* of the Fund is straightforward and unvarying.

"We invest in companies in the U.S. where the earning power is growing by roughly twenty percent," says John Dobson, Chairman of Formula Growth and one of its original founders in 1960. "To get earnings per share growing at twenty percent in a company, perhaps it has sales growing by twenty percent, or perhaps it has return on shareholders' equity growing by that percentage—so that the company can finance further growth. Our experience, and our belief, is that the single most important factor is growth in earnings per share. Since we started forty years ago, our target has always been twenty percent."

Adds Randall Kelly, the Fund's President, "We're in the business of

**Unitholders of Formula Growth value the lean efficiency of the Fund's operations. The entire administration is run by four people.**

identifying growth engines, in whatever sector. We aim at identifying superior management in charge of interesting companies that are growing earnings at a rapid rate. In a nutshell, that's what we do—and the record shows that we're good at it."

No possible argument there. Celebrating its fortieth birthday the Formula Growth Fund can boast compound growth of over 17% per annum. As the accompanying graph shows, that is extraordinary in anyone's books, and a winning score in any financial game.

The company also manages \$600 million in assets in Formula Unit Trust, a portfolio established in 1976 for Canadian tax-exempt institutions that are seeking exposure to the U.S. growth sector. The two portfolios, each pursuing the same strategy and goal, constitute the be-all and end-all of Formula Growth Limited's activity. The company has no other accounts or mandates, and seeks none.

The managers at Formula are not market timers, and they don't judge a company by its sector. They are rigidly bottom-up investors.

"The bottom up approach could lead you into sectors," says Dobson, "because growth occurs in some industries when it's not occurring in others. But compared to most, we don't put much of a weighting on sector. Nowadays, it's also increasingly difficult to tell what sector a company's in. A technology stock might fit into any one of three or four different categories. And most industries today have a technological factor that makes them go."

Why the exclusive emphasis on U.S. stocks?

"If you were trying to duplicate the Formula Growth concept in Canada, buying smaller cap stocks," says Kelly, "you'd hit the wall around \$150 million in assets. Our U.S.-centric approach is a function of our specialization. We believe

that the Fund has to maintain its rigid focus. We can't let our style shift."

Dobson adds, "Historically, over the long term, there's a dominance of natural resource and oil stocks in Canada. The great way to make money with those stocks is to time the market, buy them at the low end of their cycles. We're not going to do that, however, because such stocks are never going to have a record of consistent earnings per share."

In the most general sense, Formula's strategy is to find smaller companies that are going to grow into big companies. Most companies that are already big simply are not going to grow at the rate of smaller ones. "When they get big, like Home Depot, we don't necessarily discard them," says Dobson. "In the last four years, some bigger companies have done extremely well. Companies like Cisco and Microsoft may be big, but their earnings are still growing. Still, over the majority of their histories, the bigger companies are not going to grow at the pace of emerging companies."

There are five companies in the portfolio at present that have been owned for over ten years, and which are up over fifty to a hundred times. Formula bought MCI Worldcom, for example, in 1989 when the cost was below a dollar; it's now around forty. Then there's AIG; it was a dollar when purchased, and is selling now for about \$100 a share. In 1980, Formula bought Circuit City for pennies; it's now at \$55. In 1990 the Fund invested in Cisco, which has since gone up a hundredfold.

## 40th Anniversary Profile: Formula Growth Fund

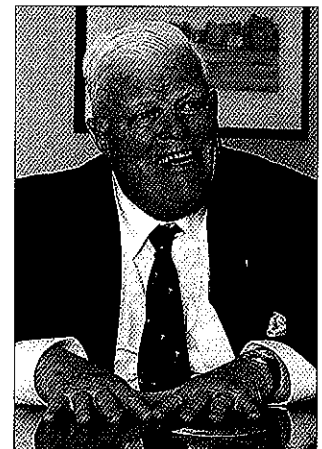


**Randall W. Kelly, President:** "What's interesting is the number of names on our list of investee companies that few people would recognize. You'll recognize a name like Cisco, or a name like MCI, but most of the others are small, dynamic companies that could become the next Cisco or MCI. That's what we're about: finding tomorrow's story today."



**Seated left to right:** John Dobson; Kimberley Holden, Vice President; Randall W. Kelly; René Catafago, Executive Vice-President; standing, from left, Anthony T. Staples, Associate; and John Liddy, Vice President.

**Formula Growth manages two portfolios. The company has no other accounts or mandates, and seeks none. Its managers are not market timers, and they don't judge a company by its sector. They are rigidly bottom-up investors.**



**John Dobson, Founder and Chairman:** "We can afford to go into smaller companies, whereas most of the players in the Canadian investment community must look for large positions. If you're running an institutional investment account, you can't go into the kind of companies that Formula Growth buys—because you can't buy enough shares to make it worthwhile. This is one of the benefits of our limited size."

"Basically," says Kelly, "we're fully invested all the time. The biggest reason for us to sell something is when we find something better."

What stocks does Formula like right now?

"Look at Rent a Center and Rent Way," says Kelly. "These stocks sell for less than ten times earnings, five times cash flow. We like United Global Com. It's an international cable company and very cheap. We like a company in Minneapolis called Value Vision, which is a home-shopping media property. We like the electronic manufacturing area and companies like Plexus, SCI, and Benchmark Electronics. We consider all of these stocks to be cheap—and they fit into the 40-year pattern of what we do."

Investors in Formula Growth are obviously exposed to volatility. The business plans of the Fund's investees, given their position in the growth cycle, must necessarily entail risk. Their stocks are also less liquid, because they have smaller market caps. "But the potential return is much greater," says Dobson. "We are swinging for the fences more than your garden variety investment house."

Formula Growth is one of the rare investment funds that doesn't seek to grow the number of its unitholders. Explains Kelly: "We're staying at our current size for good reason. We believe that the surest way to kill performance is to grow our asset base too large. Our team would start to get diffused. We have a tight talent pool to run a tight number of ideas. There are only so many good ideas around. If we doubled our assets tomorrow, we'd have to dilute the quality of the ideas that we think would work out. And that would bring us back toward the mean, back toward the market. Sure, if we became a big mutual fund company, we

might get rich quicker, but our customers would suffer. That's not our game. The current set-up allows us to manage a shop with a low management fee, approximately 1% at present, much lower than the average 2.5% in the industry. So our customers win twice."

Or thrice. In stark contrast to most investment funds, very little attention is paid to marketing at Formula Growth. The firm's resources are entirely devoted to the unitholders' capital appreciation. "Nobody has ever been paid a nickel for selling this Fund," says Dobson. "If you don't pay intermediaries, you don't get many sales. But then again, this Fund doesn't want or need sales."

Adding to the commitment at Formula is the fact that a considerable portion of the Fund is owned by its officers and employees, while the firm itself is wholly owned by its employees.

Ultimately, according to Randall Kelly, successful investing à la Formula Growth might be ascribed entirely to attitude: "To do growth stock investing," he says, "you have to be incredibly optimistic. We are the most optimistic group of people you've ever met in the investment field. Our own bias is that we've never seen any rich pessimists out there." □

# FORMULA GROWTH LIMITED

## THE COMPANY

Formula Growth Limited, founded in 1960, is a Montreal-based investment management company that manages two portfolios of United States emerging growth stocks, one for individual investors and the other for Canadian tax-exempt institutions.

Formula Growth Fund was established in 1960 and has approximately 800 individuals as investors. Formula Unit Trust was established in 1976 to accommodate Canadian institutional investors who sought exposure to the U.S. emerging growth sector. Both the Trust and the Fund compounded in excess of 20% per year for the last 10 years.

## THE PEOPLE

Continuity of professional and administrative staff is one of the principal reasons for Formula Growth's excellent performance record. The most successful investors tend to be career investors as experience gained from participating in several full stock market cycles is invaluable.

Formula Growth devotes substantially all of its time to investing and places little emphasis on marketing. Its primary objective is to increase the assets under management through capital appreciation. All officers, directors and employees of Formula own a substantial number of units in the Fund. This ensures their interests are properly aligned with those of the customers. Formula Growth Limited is also entirely owned by its employees. The principle members of the firm are:

**JOHN DOBSON** is the Chairman and founder of Formula Growth. He is a graduate of McGill and Harvard Universities and is recognized as one of the pioneers of growth stock investing. He has been investing in growth stocks for over forty years.

**RANDALL W. KELLY, CA, CFA**, is a portfolio manager and President of Formula Growth. A graduate of Concordia and McGill Universities, he joined Formula in 1984 after six years at Deloitte & Touche.

**KIMBERLEY HOLDEN, CFA**, is a portfolio manager and Vice President of Formula Growth. A graduate of Carleton University, Kim has been with Formula Growth since 1988.

**JOHN LIDDY, MBA**, is a Portfolio Manager and Vice President of Formula Growth. A graduate of Waterloo and York Universities, he joined Formula in 1995 after 4 years as a growth stock analyst in Toronto.

**ANTHONY STAPLES, CFA**, joined Formula in 1997 as an associate. He is a graduate of McGill University and spent the previous four years with a Montreal based investment management firm.

**RENÉ CATAFAGO, CA, CFA**, is the Executive Vice President of Formula Growth. He is a graduate of Université de Montréal, and joined Formula in 1987 after fifteen years in public practice.

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