

Paris Sizzles

Father-and-son team scores with small- and mid-caps

By HARLAN S. BYRNE

An Interview With Alexander Paris and Alexander Paris Jr. -- Alexander Paris discovered the value of independent stock research long before Eliot Spitzer extolled its merits. It has been more than three years since we last checked in with the head of Chicago-based Barrington Research Associates, where his son, 38-year-old Alex Jr., is head of research

(["Smaller Stocks, Big Winners,"](#)¹ July 26, 1999). Revisiting them now, we find they're still scoring nicely, even in today's choppy markets. For what they're thinking and buying now, read on.

Barron's: *Alexander, how would you describe your approach?*

Paris: Well, I've been in the investment business 40 years, so I think I've seen and done everything. Twenty years ago, I decided to begin our own firm. Originally, I set up the firm with a lot of work with economic consulting clients. Now we focus on stock research for institutional clients such as banks, mutual funds and other investment types.

We like growth companies at a reasonable price. We work primarily with small- and mid-cap stocks. We like to work primarily with companies that aren't well-covered, if at all, by Wall Street. We also deal with a handful of large companies if they aren't well-covered.

Q: *Alex Jr., to what do you attribute your investment successes?*

Paris Jr.: We've been doing pretty well in what at times has been a tough market environment the past three or four years. Four of our eight research analysts have been named Wall Street Journal Best on the Street Analysts for their respective industry research coverage the past two years. We've been doing better in face of a tough environment for several reasons. We think we are in the fortunate position to be in the center of several converging trends.



No French connection: Paris *filis et pere* have racked up big gains with their Chicago-based Barrington Research's picks of mid- and small-cap U.S. stocks.

product driven from our buy list and made available to high-net-worth individual clients as well as institutional plans. Though we've always had an asset-management operation available to high-net-worth individuals, the new product is driven by a model portfolio with the majority of its assets on our research buy list. So any additions or deletions to the buy list are reflected in the model portfolio merely at a glance. And, of course, it closely reflects our research buy list, which has outperformed the market significantly.

Q: *Looking at that buy list, Alexander, what do you like about Cognex? It's a capital-spending play, but that area's been lagging.*

A: When people talk about capital spending, they often get all confused about the bubble in technology stocks. Actually, we were in the midst of a record capital-spending boom focused primarily on the factory floor. Capital spending was generally strong, but it became heavily technology-oriented in the later years of the bubble, and that's what most people remember. But I think the real expansion in capital spending came with the demolition of the Berlin Wall, when we started competing against free-market economies suddenly. So companies had to make their factories more globally efficient. Then came the Asian crisis and even greater competition for U.S. manufacturing companies. That's the

First off, and maybe most noteworthy, is the rising demand for independent research. As country singer Barbara Mandrell might have said if she were in our position today, we were independent before independent was cool. No. 2, the trend back toward fundamental research driven by the post-bubble mentality. At Barrington Research Associates, our middle name is Research, so that's playing in our favor. Moreover, Wall Street has been abandoning small caps, generally considered those stocks with market values under \$1.5 billion. As the ties are being broken between investment banking and research, there's less incentive for Wall Street firms to cover the less-liquid smaller-cap stocks, leaving an opening for us to come in and cover the not-so-well known small- and mid-caps. Again our area of focus has been leading this latest market advance and the stocks that have done best favor our investment style, which, as my dad says, is growth at a reasonable price.

Q: *Can you quantify those results.*

A: Our small-cap buy list, for example, is up 28% year to date through July 31. That is significantly outperforming the other small-cap broad indexes like the S&P 600, which is up 12%, and the Russell 2000, which is up 17%, although those indexes have been rising noticeably in recent days. Our mid-cap buy list has climbed 18% year-to-date, versus 12% for the S&P 400 and 15% for the Russell mid-cap. Both small- and mid-caps have outperformed the S&P 500. In fact, we're doing so well with our stock picking in terms of performance, inquiries from clients led us in July to launch a new asset-management

whole thesis that led us into coverage of **Cognex**, one of our top picks, which dominates the not-well-known machine-vision industry. Machine vision can be described as computers equipped to see and spot defects and other problems in manufactured products while being assembled.

Q: *What about growth prospects?*

A: Cognex grew considerably by acquisitions of machine-vision systems of Allen-Bradley, Honeywell and others. Since its founding in 1981, the company has had cumulative revenue of more than \$1.5 billion from such systems, a lot for a fairly small company. The stock has more than doubled since last October to around 29, with strong growth prospects topping 20% a year. We think there is a lot of upside to the stock, although it is subject to slowdowns in capital spending by customers cutting costs in slowing economic times. While the company has depended a great deal on the technology market, it's really a capital-goods spending stock. The end-user market is broad, stretching from, for example, semiconductors to such diverse products as diapers, candy bars, cutting tools and entire auto bodies, with machines always looking for flaws in the manufacturing process.

Q: *Another company on your top-10 list four years ago and still today is **Kaydon**. Alexander, I guess you still like it.*

A: Yes. It's a cyclical stock and it went through a difficult period when many manufacturers were cutting back on a lot of things, including capital spending. The company makes highly engineered products used by manufacturers in many industries. After a downturn earlier this year, **Kaydon** stock has been on a sharp climb, in line with our philosophy that in weak periods, as we've had, that's the time to throw money at a stock like Kaydon. The company is a way to play the broad-based upturn in the industrial and capital spending. To its advantage, Kaydon has been a strong cash-flow generator and very good at seeking acquisitions. The stock recently topped 20 after touching a low of 15 earlier in the year. Our buy list is heavily tilted toward cyclical stocks. Knowing which stocks to buy and when is important. As for timing, we're currently bullish on the economy and the stock market.

Q: *Alex Jr., could you give us ideas about other companies on your top-10 list?*

A: I'll mention a couple of names that I have personally put on our buy list -- **G&K Services** and **UniFirst**. These are probably good to talk about together since they're very similar in what they do. Both companies are leaders in the uniform-services industry. They put uniforms on the backs of American workers. They're cyclical in that their fortunes are very much tied to employment levels within the company. Even in recent tough economic years, many of their clients have done reasonably well, to the point where more than 90% of their clients' customers are retained year to year. They have a very high level of recurring revenues, which gives management great visibility in planning. With that said, these companies aren't recession-proof, and their internal growth slowed in the last few quarters. That is beginning to turn. The internal growth rate has stabilized, and based on our expectations for the economy, we think G&K and UniFirst will be direct beneficiaries of expected improvement in the labor market.

Q: *How have the stocks done?*

A: They've done reasonably well so far this year, but you can still buy them at prices below private market value. They trade at prices below acquisition activity that's been occurring in this market.

Tables: [Top Picks | Quarter-End Comparative Performance](#)²

Q: *We know one of your favorites, Alex, is **ITT Educational Services**. You also have **DeVry** on Barrington's big buy list of 37 stocks.*

A: We are big bulls on education. There is a need for education reform in this country at the K-12 level and there is increasing demand for education at the post-secondary level. We like DeVry stock very much, as well as ITT. For the purpose of this interview, we chose ITT Educational as our preferred way to talk about the post-secondary-education sector at this point. Post-secondary education now seems countercyclical. What I'm saying is that when unemployment is high, more people choose to go to school or go back to school to advance their education.

Q: *So what happens when the economy begins to improve?*

A: You would expect a slowdown in enrollment. But every recession is a little different. What's different this time is that this economic contraction has been driven by reversing the excesses of the information-technology bubble of the late 'Nineties. So it's had a disproportionately negative impact on colleges that train students for careers in technology. ITT has been a leading provider of education for careers in things like computer-aided drafting, electronics, computer networking and other information-technology fields of study. The company then should benefit on the other side of the business cycle as information-technology employment recovers.

Q: *What shape is ITT in financially?*

A: The company is debt-free. It's the cheapest stock relative to competitors in its group. It has the highest return on equity and on invested capital. We have an Outperform rating on the stock and believe it's suitable for longer-term portfolios.

Q: *Of the companies you list as your top-10 picks, is there one that would stand out over the others?*

A: I don't know if it's a fair question. We cover over 100 companies here at Barrington Research and we try to come up with a portfolio of names that represent the best values at this particular point in time. Keep in mind that it's heavily focused on cyclicals and focused entirely on small- and mid-cap stocks. And we want to be somewhat diverse in our recommendations. We have manufacturing industrials, some education and some health care, as examples.

Q: *Speaking of health care, Alex, one of your top picks is **Henry Schein**.*

A: Yes, we've been very pleased with the performance of Henry Schein over the past couple of years and especially the year to date. The stock is trading around its 52-week high, yet still at only a market price/earnings multiple -- about 19 times estimated earnings for calendar 2003 and 16 times next year's. We believe Henry Schein is clearly gaining market share in each of its operating segments. We see good sales growth ahead and great opportunity for the company to continue to increase its operating margins over the next three to five years. We recently raised our 12-month price target on the stock to 71 from 63. And even that 71 price target is based on only applying a 20 times multiple on our 2004

estimate of earnings. So there's a lot of upside to our price target, and this company will continue to grow based on doing what it does well as a major distributor of medical, dental and other health-care products. And it's a beneficiary, of course, of the graying of America.

Q: *And what's the stock trading for now?*

A: About 57.

Q: *Alexander, what about **Robbins & Myers**?*

A: We just upgraded it a few months ago to one of our top picks. Again because this is a cyclical company and compared to the other ones on the list that we gave you, it's almost 100% capital spending-oriented. Capital spending generally will lag the industrial sector, which in turn lags the consumer sector. So we're just getting to the point of starting a turnaround. It's a small- and mid-cap kind of company. They're in three different areas. The biggest is pharmaceuticals, but most of what they do, except in the energy field, is tied to factory-floor systems, from mixers to other kinds of equipment used in manufacturing processes. A big acquisition -- of a private company, Romaco -- made the pharmaceuticals business their largest by far, and making for a very good story. The acquisition also made Robbins & Myers' business a lot less volatile and strengthened its long-term growth prospects.

If you looked at a typical drug company, whether it's a giant like Pfizer or a little company we cover like Perrigo, they pretty much make everything from the raw materials coming into a plant to the packaged pills going out for distribution. Robbins & Myers makes the equipment used in the manufacturing process. They essentially do the same with industrial equipment they make. For energy producers they turn out equipment used in exploration, which like industrial equipment, is doing nicely, thanks in large part recently to cost-cutting. Robbins & Myers stock has moved up sharply in recent months and is considered in a good position for more gains in the year ahead.

Q: *What about **Regal-Beloit**, which also is on your top-10 list?*

A: It's much like Kaydon in that it's a very efficient, low-cost producer. They also know how to make acquisitions, having made over 40 of them. They're very successful in integrating acquired companies. Much of their work in the past had been making gears, gear drives and gear boxes for a broad list of industrial customers. I think the interesting thing here is that the downturn in the industrial sector has been so long that **Regal-Beloit** completely changed its face through several comparatively big acquisitions. It's made itself the No. 2 producer in the U.S. of industrial motors and generators. By its integration efforts, the company has put itself in position to begin reaping benefits, likely next year. With top-line growth next year, you may see some surprisingly good profit margins.

Q: *What's the outlook for **IDEX**?*

A: It's a very high-quality company, with really good growth over a period of time. It's another manufacturer of highly engineered and generally high-margin products. The products mainly are for pumping systems, including fire trucks and industrial dispensing equipment. The company is highly efficient and has achieved leading market positions in a number of its products. The company is strong financially and positioned well for better earnings growth.

Q: ***ServiceMaster** is on your top 10 list, Alex, even though it has gone through a tough period. What do you see for the stock?*

A: For the next 12 months, we have a price target of 12 a share, up from 9.50 recently, or an increase of more than 20%. Results have been impacted this year by a weak economy, and higher energy costs, affecting the big fleet of motorized equipment pest control and lawn care, and above all, poor weather. Meantime, Jon Ward, who took over in a management shake-up a couple of years ago, has made a lot of changes to cut costs and do a better job of marketing. We don't expect much improvement in earnings this year, but we're optimistic about 2004. We think the stock is attractive as a turnaround stock, including a dividend yield of more than 4% currently.

Q: *You have, of course, many other stocks on your recommended list, including dental-supply companies such as **Patterson Dental** and **Dentsply International**, as well as **Hewitt Associates** and **Lindsay Manufacturing**, to name a few. And some of your past favorites, such as **Fortune Brands** and **Newell Rubbermaid**, have grown into large caps. At the other end of the spectrum, you've recently started covering an interesting micro-cap company, **Zila**, with a \$150 million capitalization. Alex, what's the story there?*

A: As far as I know, we're the only firm covering it. They are a Phoenix-based maker and marketer of pharmaceutical and biotechnology products. We were very disappointed in previous management, since replaced. The sizzle of the story is they have a highly efficacious product that can detect cancerous and pre-cancerous lesions inside the mouth, as well as other applications. The product is in latter stages of the Food and Drug Administration approval process. So this is a biotech company that breaks even. The big if, of course, is FDA approval, which if obtained would make the company significantly more profitable. At current levels, we think the stock price doesn't reflect the growth opportunities.

Q: *Alexander, what do you see ahead?*

A: The bear market is clearly over. We are in a new bull market, a sustained advancing market. I think a lot of people have been looking for the economy and the market to take off. To me it's going to be a slow, steady recovery, a stock-picking kind of market, just exactly where we operate.

Q: *Thank you, gentlemen.*

E-mail comments to editors@barrons.com³

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Barrington Research's Top Picks

Company	Symbol	Recent	EPS Estimates	
		Price	2003	2004
Cognex	CGNX	\$29.09	\$0.40	\$0.70
G & K Services *	GKSRA	32.85	1.70	1.95
I dex	IEX	38.31	1.92	2.30
Kaydon	KDN	25.27	1.24	1.49
Regal-Beloit	RBC	22.00	1.09	1.42
Robbins & Myers **	RBN	22.46	1.02	1.35
UniFirst**	UNF	25.95	1.55	1.75
Henry Schein	HSIC	56.99	3.08	3.53
ITT Edu. Services	ESI	40.55	1.21	1.46
ServiceMaster	SVM	9.65	0.56	0.62

*Estimates for fiscal years ending June 2004 and 2005

**Estimates for fiscal years ending August 2003 and 2004

Source: Barrington Research

QUARTER-END COMPARATIVE PERFORMANCE *

Index	2nd Qtr	YTD
BR Small-Cap Buy List	24.4%	27.5%
S&P Small Cap Index	19.6	12.4
Russell 2000 Index	23.0	17.0
BRMid-Cap Buy List	20.0	17.6
S&P 400 Mid-Cap Index	17.3	11.7
Russell Mid-Cap Index	17.8	14.6
S&P 500 Composite Index	14.9	12.6

*As of July 31, 2003

Source: Barrington Research

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