John Deysher, Portfolio Manager interview- Lori Pizzani, Fundemail June 13, 2003
The **Pinnacle Value Fund** prefers to lean into the smallest capitalization area of the market. It likes to get up close and personal with companies that haven't yet blipped onto mainstream analysts' radar screens, or walk into an air traffic controller's worst nightmare and scoop up companies that have fallen completely off radar. The Fund's manager believes he can achieve oversized gains with undersized companies, and possibly grab some dividend yield along the way to reward investors for their wait.

That contrarian approach means shopping for bargains and hanging on to winners. While the Fund is less than three months old, it's in positive territory, and worthy of a look.

Manager Insight

In this issue, Fundemail's managing editor Lori Pizzani interviews John E. Deysher, portfolio manager of the $2 million **Pinnacle Value Fund** (No NASDAQ symbol yet). Mr. Deysher is President of Bertolet Capital LLC of New York, the fund's adviser which has managed the Fund since its April 1, 2003 inception.

Fundemail: The Pinnacle Value Fund may be new, but you aren't new to the mutual fund industry, right?

Deysher: Right. Before starting Bertolet Capital in January and the Fund in April, I worked for 12-plus years as a portfolio manager and senior research analyst with Royce & Assoc. which manages mutual funds here in New York. Royce specializes in managing small cap value stocks. All told, I have two decades of industry experience.

Fundemail: The Pinnacle Value Fund can invest in common stocks as well as preferred stocks and convertible securities. Why the broader mandate?

Deysher: We manage the Fund for total return. Our goal is to give investors a 2% or 3% yield while they are waiting for the securities to appreciate. We won't invest in common stocks unless we think the stock can double or triple over the next two to three years.

Right now we own the preferred stock on a REIT, Price Legacy Corp., which is yielding 8-1/2%. It was structured by Sol Price who used to own Price Club before it merged with COSTCO in 1994. The REIT owns the real estate that 42 shopping centers sit on with key tenants like Costco, Home Depot, Lowes and Sports Authority.

Fundemail: The Fund focuses its attention on the micro- and small cap universe. Why is this the sweet spot of the market for you?

Deysher: Small and micro-cap securities tend to trade under radar screens. Many are what I call "orphaned" stocks that no one pays much attention to. They often don't get coverage from stock analysts, and that lack of interest usually makes for better values. Also, lots of other portfolio managers cannot invest in stocks under $100 million or even under $200 million so there are fewer analysts watching.

The sweet spot for us is any company under $400 million in market cap, and we have lots under $100 million. But a comfortable floor for us is within the $8 to $10 million range. We normally won't buy companies smaller than that because they can be really fragile, are often over dependent on a key customer, product or senior executive.

Fundemail: But, if analysts aren't covering these smaller companies, doesn't that mean more work for you?

Deysher: Yes, it certainly does. Investing in smaller companies is much more labor intensive and requires more research. One of our biggest challenges is gathering the intelligence, which you have to do yourself. So we talk with their management, their competitors, their suppliers and others. We talk to people who often have no vested interest in speaking with us. We try to become as knowledgeable as possible beforehand so in exchange for their insights and thoughts, we can offer them information about something they didn't know. We try to make it a two way dialog.

Fundemail: Where do your stock ideas come from?

Deysher: We get ideas from many places, including the Wall Street Journal table showing the stocks making New Lows each day. We also carefully look at SEC filings. We follow 13D and 13G ownership filings of smart, successful small company investors. We also review Warren Buffett's Berkshire Hathaway filings every quarter. Sometimes there is an idea that we haven't heard of before that's small enough for us.

We have a nice network of brokers who we talk to, and we attend trade shows and trade association conferences. We read lots of publications and reports.

Fundemail: What do you ask when you talk with a small company's management?

Deysher: We try to understand what they think are the key issues critical to a company's success over the next few years. What are their strategic, financial and operating priorities? Do they understand the concepts of capital allocation and incentive compensation? We always wrap up our dialog by asking: Who is your toughest competitor? Who is your best vendor, and who is your best customer?

Fundemail: What do their answers tell you?

Deysher: It tells us whom they really respect and gives us insight into how they think about their company within the competitive landscape. We may also obtain new investment ideas that are worth further analysis

Fundemail: Do you talk with the top brass at every company you own?

Deysher: We interview the CEO and/or CFO whenever we can. Some companies simply won't talk to us. That doesn't prohibit us from buying that company if we like it.

Fundemail: The fund has almost $2 million now. What is a comfortable number of securities for you to hold in the portfolio?

Deysher: Well, we are not yet fully invested. We have only 12% of the fund's assets invested now. We have about 15 or 16 securities in the portfolio right now, and are holding the other 88% in a money market fund. Once we are fully invested, a comfortable number will be from 80 to100 securities.

The Fund's charter allows us to take fairly significant positions up to 10%. We will have a handful that will represent 4% or 5% of the Fund. We'll have a bunch or 2-4% positions. We'll also have lots where we will own 2% or less, especially where we are just getting to know the companies. But we are diversified across industries and sectors.

Fundemail: So, you apparently aren't afraid to hold cash?

Deysher: We're not afraid to hold cash. We would much rather earn 1% in a money market fund than lose 10% because we paid too much for a security. Paying too much for a security can turn a good investment into a poor one.

We're not sure that the recent rally we've had is sustainable. Yes, we have now removed the uncertainty of war with Iraq. And after three years of a bear market, people are looking for a recovery. But people are tossing money into the market now, and we're unsure the recovery will justify current valuations. There have been a lot of managers covering short positions, which has contributed to the rise in the market, too.

Fundemail: Conversely, you've indicated that down the road, too much cash could hurt the Fund and you would consider closing the fund and not accepting new investments.

Deysher: That's true. We expect to close the Fund at some point. We don't know if we will close it at $100 million or $500 million, but we won't dilute the quality of investment ideas just to grow assets. That's something that can happen if this kind of fund grows too large. The problem then becomes how to put that money to work. Often managers must migrate to bigger companies, or change their investment style. We call this market cap or style creep.

Fundemail: Speaking of style, what particular characteristics do you look for in companies you invest in for this value fund?

Deysher: We look for companies that employ conservative accounting methods and have strong balance sheets. We also look for companies whose management is entrepreneurial. They have to think like owners. We also like it when they own a lot of stock in the company. When they own considerable stock, they pay more attention to capital allocation and don't do dumb things just to satisfy Wall Street. These companies must also have an understandable business model. If we can't understand the business model fairly quickly, we'll move on to something else.

Fundemail: Have the recent past financial reporting scandals brought new emphasis to the concept of conservative accounting?

Deysher: Yes, the past scandals have emphasized the importance of conservative accounting. It's certainly not new for us to look for conservative accounting. But micro-cap companies can be so much more vulnerable to economic slowdowns. We want to invest in companies that are able to survive and we weed out most others.

Fundemail: How does your value style come into play?

Deysher: We are contrarians. We invest in companies that are out of favor, but which have a strong balance sheet to get them out of their current troubles. Then we look for a catalyst to turn the company around, although we don't require that there be a catalyst.

Once we own a company, we like it when other analysts and managers begin to pick up that company on their radar. But if a company has fallen off radar and becomes undervalued, that's when we get interested.

Fundemail: What type of catalyst do you want to see?

Deysher: It might be a new management team that comes in, or a new shareholder base where someone with a 5% or 10% position surfaces and starts pushing for change. Sometimes, it's the decision to begin a divestiture program, where the company has done too many acquisitions and now needs to sell off non core assets. Conversely, they may decide to make strategic acquisitions. Sometimes a company will decide to adopt a share repurchase program or the insiders will begin accumulating shares. With all of the choices companies or managers have on where to invest capital, if they're willing to invest in their own stock, that's a normally a pretty strong signal to us.

Above all else, we try to avoid value traps.

Fundemail: What are value traps?

Deysher: A value trap refers to a stock that looks cheap, probably is cheap, and stays cheap forever. It never appreciates because nothing really changes- there's no growth or things don't get better. For some companies, it is difficult to change. The only way to make money is if they are acquired which may never happen. Right now there are several companies that meet all of our other criteria, except that we feel they are value traps.

Fundemail: You also invest in so-called "special situation" securities. What are these?

Deysher: We do a lot of detailed work, and we aren't afraid to traffic in turnarounds. These may include broken IPOs which are IPOs that come to market with unrealistic expectations. Perhaps management is overly optimistic, or the IPO has been over-hyped by investment bankers. These companies come to market with rich valuations that hold up for a year or two. Then earnings drop and P/Es shrink leading to a share price decline.

A great example of a broken IPO is AirNet Systems (ANS), a $40 million market cap which is a major holding. It came to market six yrs. ago, and got as high as $30 per share before falling to $4 recently. The company provides fast, critical air shipping for things such as organ transplants and checks that banks must physically have in order to pay.

The new check truncation legislation which will allow banks to clear checks via electronic check presentment will mean that part of AirNet's business will disappear. But they've been changing their business model and providing services to businesses who need to fly cargo and charter services to individuals and groups. They've been growing and we think the liquidation value of their planes is higher than the current share price .

Fundemail: With the stock market up recently, are you finding pockets of value now?

Deysher: Yes. Right now the manufactured housing industry is very depressed. There's little or no financing in manufactured housing, and unit sales have come down 65% over the last five years. So that's an area we are interested in. Also, recreational vehicle manufacturing companies are depressed. Winnebago (WGO), for example, just warned about its earnings. The aerospace and airline industries are also quite depressed, and there are a lot of small companies that exist in that area.

Fundemail: What about your sell discipline?

Deysher: We will often sell if a security hits our price target. We have buy and sell triggers on every security which are adjusted accordingly as events unfold. That allows our winners to continue to generate profits even if they have appreciated past their target price. We are comfortable maintaining a security that has appreciated significantly so long as events continue to track plan. Of course that doesn't mean that at the higher price we would initiate a position.

Did you ever hear Peter Lynch (the former Fidelity Magellan Fund guru) refer to 10-baggers? Those are stocks that appreciate 10 times their value generating significant returns. Well, one way to capture a 10-bagger is to let a security grow and appreciate. We will hold a security until we think it is fairly valued.

We'll also sell if we've made a mistake -- in our facts, our judgment or our reasoning -- or if the catalyst or trigger we expected doesn't happen. If it's obvious that something good won't happen after 2-3 years, we'll scale back. If a company is doing well but the price just doesn't reflect that yet, we will maintain our position.

Fundemail: What makes your Fund unique?

Deysher: We're in a really specialized asset class of neglected, overlooked and orphaned securities. Also, we can go small, *really* small. We also don't think with the crowd. We take lots of contrarian stances. When others are selling, we're often buying (and vice versa). We invest on the basis of valuations and fundamentals, not popularity. Our goal is to generate meaningful long term returns on a tax efficient basis.

My family and I have a substantial amount of money invested in the Fund. That's one of our core principals, both for us and the companies we invest in. People who run a business should have their wallet on the line every day, just like we do.

FundEmail Data

Load/No Load	No-load
Mgt Fee	1.25%
12b-1 Fee	.25% (but not currently implemented)
Minimum Initial	$2,500 ($1,500 for IRA)
Redemption Fee	1% if redeemed before one year
Minimum Additional	$100
Morningstar Category	N/A
Morningstar Rating	Not Yet Rated
Lipper Category	N/A
Lipper Rating	Not Yet Rated

Total Return as of June 13, 2003:

From fund inception (4/01/03) +3.40%

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Lori Pizzani is a New York-based freelance journalist specializing in mutual funds and personal finance. She is currently the editor-at-large for a nationally recognized weekly mutual fund trade publication and writes a recurring column for mutualfundcareers.com. She has written for cnbc.com, and worldlyinvestor.com, as well as several highly regarded financial services magazines. She previously served as the managing editor of a monthly mutual fund trade publication. Before beginning her writing career, she worked for seven years within the mutual fund industry.