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Interview With Michael van Biema

Founder and Managing Partner
van Biema Value Partners

Enduring Lessons

By Lawrence C. Strauss

Brad Trent for *Barron's*

I will never forget the finance class I took with Professor Michael van Biema.

It was 10 years ago at Columbia University's graduate business school, and van Biema held the class in rapt attention. I recall, among many colorful and spirited lectures, a tirade about how synergies between companies slated to merge are often oversold by Wall Street. "There are never any synergies!" he screamed at the end of a case study.

He railed against cheating–cheating in class and cheating in life. And he'd often veer from the textbook, spinning captivating yarns on subjects ranging from Warren Buffett to Jeffrey Vinik, the former manager of Fidelity Magellan, to the expenses and risks of growth by fledgling companies.

So, when I heard that van Biema–still based in New York City–is now running a fund-of-funds business specializing in value-oriented hedge funds, I naturally was curious. How, exactly, was he applying Columbia's rich tradition in the study of value investing to the modern world of hedge funds?

Columbia, of course, is where Benjamin Graham, starting in the 1920s, developed the framework for value investing, as a professor and author of such classics as Security Analysis, co-written with David Dodd.

This investment style entails finding securities whose values, owing to various factors, are below their intrinsic value, creating long- term opportunities.

Among the value-investing practitioners to graduate from Columbia's business school are Mario Gabelli, a longtime member of the Barron's Roundtable; Chuck Royce, of the small-cap Royce Funds; and, last but certainly not least, Warren Buffett, class of 1951.

van Biema arrived at the business school in 1992, after collecting a doctorate degree from Columbia in computer science and working as a strategy consultant and technology entrepreneur. He had launched several computer companies and moved on to technology investing.

The timing of his return to Columbia proved fortuitous. A value renaissance was just getting under way on the Morningside Heights campus, because Gabelli had arranged for Roger F. Murray, a retired Columbia business-school professor who had edited several editions of Security Analysis, to give a series of lectures on value investing. A class on the craft was started, along with an annual value-investing breakfast. van Biema, who had been searching for a reliable investment method, soon was hooked.

"It just struck me that value investing made so much sense," he recalls.

The approach, as he sees it, boils down to this: "It is very difficult to value things, and it's impossible to value companies that are growing very rapidly, so value investing tries to [divide] the world into things that one can value in a reasonable fashion and things that one can't value."

The true value investor, in his view, ig-

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Team Value: Michael van Biema, right, with partners Alan Kahn, center, and Curtis Lee.

nores the companies that can't be valued. For example, a promising technology could easily become obsolete, its current potential and hype notwithstanding.

The original value investors like Graham, van Biema says, “never look at the income statement” and “they don't really care what the operations of the company are.” Bottom line: “They are asking themselves, 'Can I buy 50-cent dollars?'”

During his 12 years at Columbia, van Biema became a forceful proponent of the approach. He is “good at explaining why value works and what you can expect to get from it,” says Bruce Greenwald, the school's Robert Heilbrunn Professor of Finance and Asset Management.

Then as now, his observations about business and investing were grounded in the hard school of knocks. “It's one thing to say, 'Here's a spreadsheet and here's a homework assignment,” he says. “But nobody hands you the right spreadsheet to fill out with the right columns. You've got to figure it out yourself.”

van Biema, now 50, seems to be figuring out the hedge-fund business just fine. van Biema Value Partners, formed in 2004, runs two funds—one domestic and one global—that invest in hedge funds run by value managers. Most of those funds are small, with less than $200 million under management. They are not greatly different than value-investing mutual funds, but they do have more flexibility to use leverage, take short positions and carry out other maneuvers.

The firm has a total of $155 million under management, mostly in the domestic fund. From inception through Sept. 29, the domestic fund is up 25.8%, versus 24.4% for the Standard & Poor's 500. That's a respectable showing, considering that a key goal is to preserve capital over time. Eventually, van Biema hopes to grow each fund to between $400 million and $500 million.

As he proceeds, van Biema is benefiting from a Rolodex stuffed names gathered at Columbia. His funds' board of advisers, which helps vet managers, includes Gabelli; Royce; Charles Brandes of Brandes Investment Partners, the institutional value shop in San Diego; Alan Kahn, a longtime value investor and formerly of Kahn Brothers; and Peter Cundill of the Cundill Group. Former students now in the investment business also have proved to be valuable contacts.

Kahn, who also is a partner in the firm, initially was skeptical about the fund-of-funds idea. Fund of funds charge an extra layer of fees—on top of those assessed by the underlying hedge funds. But in the end, he came around, convinced that van Biema had access to a stable of talented value managers whom investors wouldn't find otherwise. Perhaps not surprisingly, van Biema declines to name any of the 23 managers the fund invests in, citing competitive reasons.

Kahn also maintains that van Biema's background in computers and technology, as opposed to traditional finance, helps him look at things with a fresh eye. “That is a very strong plus,” he says.

In searching for managers, van Biema doesn't use quantitative screens. Instead, he relies on referrals from his network of contacts. “My favorite type of managers are guys who usually have come out of a well-known value shop,” he says.

He also looks for managers who are tested and “who actually have been through some market downturns.”

He prefers small hedge funds because “size is the enemy of performance.” Hot shots right out of business school need not apply, and he doesn't take a shine to funds that use a lot of leverage. “Leverage cuts both ways, and eventually it's going to cut the other way,” he says.

The managers tilt heavily to being long. The overlap of securities held by all 23 managers is about 8%. Right now about 80% of the assets are invested with 10 managers, though that's expected to broaden over time.

In this day and age, there is a lot of crossover between growth and value investing, as evidenced by Morningstar's blend categories. van Biema, however, doesn't invest in growth-at-a-reasonable price managers.

Why?

“You should be getting growth for free because growth is unpredictable, and the value of growth is unpredictable,” he says.

van Biema and his team invest in a range of value styles, including those mangers who look for cheap assets, but he sees common threads among all capable value managers. One is the conviction to take a contrarian view on a security; another is the ability “to segregate information into what's knowable with a high degree of certainty” and what's not. A third theme is that good value investors have a “behavioral” advantage,“ as van Biema puts it.

”The discipline requires you to sit for long periods of time on your hands and not buy anything when there's nothing out there that's reasonably priced,“ he says. ”That's a very difficult thing to do and it requires a lot of self control.“

When a hedge fund is deemed worthy, van Biema likes to start with a small investment, typically around $1 million, and he often moves quickly on a decision, sometimes after three months of vetting. ”I would much rather look at a fund for three months, give them $1 million, let them actually work with that $1 million, and build up my allocation over time.“

van Biema Partners has both high net-worth and institutional investors, including Boston College, where the Columbia network helped. Gabelli, a member of the Investment and Endowment Committee at Boston College, arranged for van Biema to make a presentation. The committee subsequently made an investment.

”We normally don't go with a new fund but wait to see how they do,“ says Robert Morrissey, chairman of the committee. But the van Biema investment, whose amount was not disclosed, has ”worked out very well for us,“ he says.

Investors can opt for a lockup, which prevents withdrawals for a specified period of one, two or three years. The three-year lockup comes with a management fee of 0.50%, compared with 1% for a one-year lockup.

Performance fees are set a on a sliding scale, with the firm getting no fee for annual performance of 0% to 5%. Those fees move up to a maximum of 20% for an annual return, net of fees, of 20% or higher.

van Biema has fired a few managers, although not for performance reasons. One, a micro-cap manager, ran out of capacity to take much additional money. Reasons for dismissal can include style drift, extended underperformance and significant personnel changes.

Just like a stockpicker, van Biema must pick good managers and avoid the lemons. ”We are going to make some mistakes over time,“ he says. ”But what gives me more confidence is that I am not judging these people based on my few days of interviews and my one-hour board meeting.“

After listening to van Biema, I dug up my old notebook from his class at Columbia. I studied the course overview that he delivered, with characteristic bluntness, on the first day. We would be learning about such things as financial forecasting, company valuation and capital budgeting, or, as I scribbled, ”How do you spend the $ you have?“

Then I came across a particularly pointed piece of advice: You must prepare for class. Looks like the professor has taken that lesson to heart. ■