

Forbes

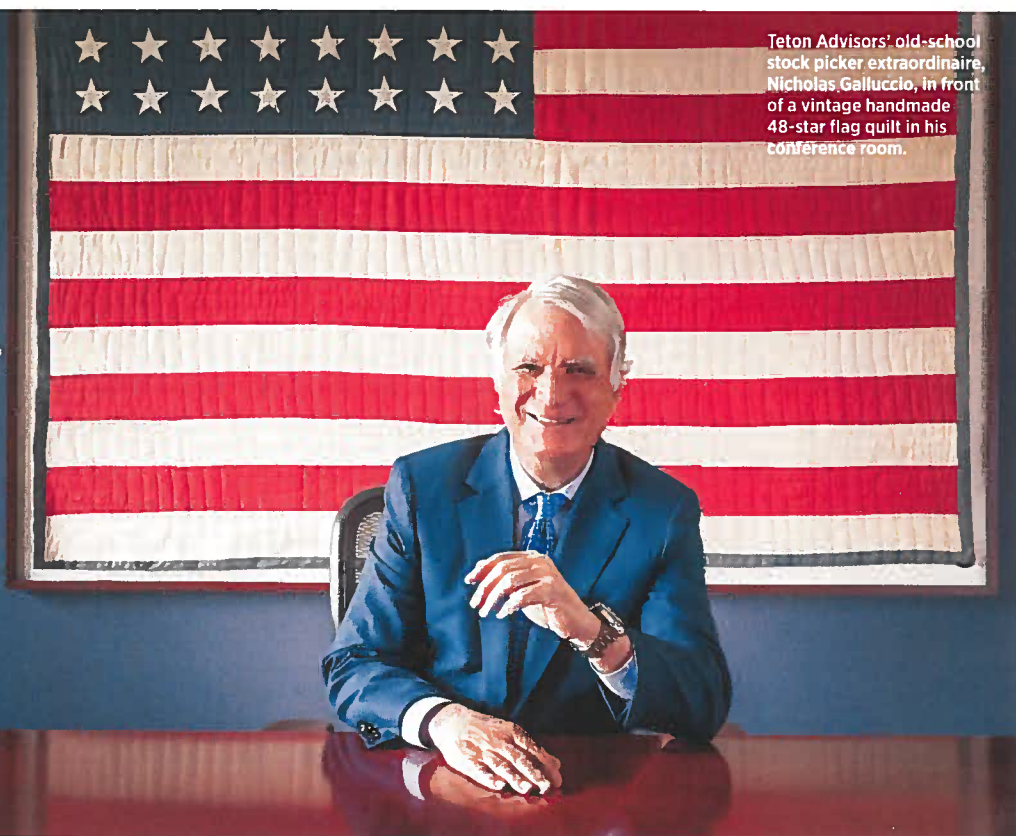
Investing

WEALTH MANAGEMENT

American Picker

As money continues to gush into ETFs and tariffs weigh heavily on multinationals, smaller companies remain a refuge for old-style value investors like Nick Galluccio.

BY MATT SCHIFRIN



Teton Advisors' old-school stock picker extraordinaire, Nicholas Galluccio, in front of a vintage handmade 48-star flag quilt in his conference room.

FRANCO VOGT FOR FORBES

If ever there was a fitting setting for a by-gone business, it is the sprawling two-story brick headquarters of the money management firm formerly known as Gabelli Asset Management, in Rye, New York. Situated about a mile from Playland, an amusement park whose past-its-prime attractions have more value as historic landmarks than as viable entertainment, Gamco Investors, as it's now known on Wall Street, is a place where old-fashioned bottom-up fundamental analysis still reigns supreme. Problem is, demand for the kind of stock picking that made Mario Gabelli a legend is at an all-time low. Gamco's assets peaked in 2014 at \$49 billion.

Yet tucked into a bright and modern five-room office suite on the main floor of Gamco's 60,000-square-foot headquarters, just past a forbidding Tudor-style paneled lobby,

is an affiliate whose time may be now. Under the direction of Nicholas Galluccio, \$3.3 billion (assets) Teton Advisors is laser-focused on finding bargains among small companies. Galluccio's in-the-weeds approach to stock picking, combined with a near perfect storm of favorable macro factors for investing in small caps, could bode well for Teton and Gamco.

"All the trade jawboning has really rocked large-cap global companies this year," says Galluccio, 68. He points out that only 20% of the revenues of Russell 2000 small-cap index companies comes from overseas versus 40% for the larger caps in the Russell 1000.

Galluccio wastes no time getting into the nitty-gritty of individual stocks. His favorites these days are what he calls "old tech": forgotten technology firms with good market positions and recurring revenue streams.

Companies like Entegris. Founded in 1966 not far from Massachusetts' Route 128 corridor, it makes clean-room filtration systems for semiconductor companies, as well as specialty chemicals that its chip-manufacturer customers use to make wafers. "These aren't app companies," he says. "These are industrials, the building blocks of the internet." Galluccio adds that Entegris has a 90% customer-retention rate and modest debt. He has owned the stock since 2008, when it sold for \$3 and had a market cap of \$400 million. Today it trades for \$35 a share.

While Galluccio prefers to talk about his individual undervalued picks, he's ready to make the case for the small-cap sector in an era of FAANG dominance. In the past decade, more than \$1 trillion has flowed out of actively managed funds and mostly into large-cap index ETFs, he notes. But small

caps are one of the true remaining areas of widespread inefficiencies, where active management can add value. "If you look at analyst coverage, 45% of small caps have no research at all," he says. Moreover, Galluccio argues, political tailwinds, including lower corporate taxes, a relaxed regulatory environment and overdue fiscal stimulus, as well as the accelerating economy, mean that small, domestically focused companies are the most levered to current conditions.

The best reason to pay attention to Nick Galluccio is his \$77 million Small Cap Select Value strategy and its results. Over the past three-year period, his mutual fund, the TETON Westwood SmallCap Equity Fund, ranked in the top 5% among 613 in the small-blend category, according to Morningstar. It's been in the top 15% for the past five years. In 2016, when small-cap stocks led the market, Galluccio's no-load fund had a total return, after expenses, of 31% versus 21% for the Russell 2000. Last year its 15.9% return outpaced its benchmark by more than three percentage points.

Galluccio's path to portfolio management is hardly typical. A Connecticut native who taught guitar during college and earned a master's in English literature from Columbia University, he developed an interest in business while exposing local corruption as a reporter at the *Springfield Daily News* in Massachusetts. After earning an M.B.A. from Columbia in 1978, he went to work as a reporter for *Forbes*. That year, he wrote the magazine's first cover story on an emerging phenomenon in finance—leveraged buyouts. His story, "Do You Sincerely Want to Be Rich?" shed light on a new firm, Kohlberg Kravis Roberts & Co., which then had just \$30 million in capital. Seeking riches himself, Galluccio jumped to Lehman Brothers in 1980 as an analyst covering semiconductors. His research there got the attention of Robert Day, founder of Los Angeles' Trust Company of the West, whom he had profiled at *Forbes*. Day recruited Galluccio to cover small-cap stocks. He worked side by side with legendary investor Buzz Zaino in New York during the 1980s and 1990s, with Galluccio's fund beating his benchmark by an average of 300 basis points annually over his 25 years there.

Then, around 2004, Galluccio began having breakfasts on Saturdays at the Putnam Diner in Greenwich, Connecticut, with Mario Gabelli, who had been Zaino's classmate at Fordham University. In 2007 Gabelli asked Galluccio to quit TCW and run one of his un-

TETONIC BUYS

IN TODAY'S ROBO-INVESTING, ETF-DOMINATED MARKET, OVERLOOKED SMALL-CAP GROWTH STOCKS ARE STILL A GOOD VALUE.

COMPANY/TICKER	MARKET CAP	PROJECTED EV/EBITDA	COMMENTS
PATTERSON-UTI ENERGY/PTEN	\$3.9 BIL	4.2X	DOMESTIC SHALE DRILLER AND FRACKER HAS DIVERSIFIED BASIN EXPOSURE AND A HEALTHY BALANCE SHEET
ETHAN ALLEN INTERIORS/ETH	\$657 MIL	7.9X	UNDERVALUED FURNITURE-MAKER HAS POSITIVE EARNINGS LEVERAGE FROM ITS VERTICALLY INTEGRATED OPERATIONS
UNITED FINANCIAL BANCORP/UBNK	\$912 MIL	1.4X ¹	COMMUNITY LENDER IN CENTRAL NEW ENGLAND TRADES AT A DISCOUNT TO PEERS
MEREDITH CORP/MDP	\$2.3 BIL	6.3X	DIVERSIFIED MEDIA COMPANY RECENTLY ACQUIRED TIME INC.; IN THE PROCESS OF PAYING DOWN DEBT
EXTREME NETWORKS/EXTR	\$955 MIL	7.4X	NETWORKING INFRASTRUCTURE COMPANY HAS EXPANDED THROUGH ACQUISITIONS; COMPETITOR TO LARGER CISCO AND HEWLETT-PACKARD
HEMISPHERE MEDIA GROUP/HMTV	\$558 MIL	9.8X	HISPANIC BROADCASTER IS POISED TO RETURN TO GROWTH AS ITS LARGEST MARKET, PUERTO RICO, RECOVERS
MUELLER WATER PRODUCTS/MWA	\$1.8 BIL	9.0X	MANUFACTURER OF VALVES, HYDRANTS AND OTHER RELATED PRODUCTS IS WELL POSITIONED TO BENEFIT FROM INFRASTRUCTURE SPENDING.

¹CURRENT PRICE/TANGIBLE BOOK VALUE AS OF 06/25/2018.

derperforming subsidiaries, Teton Advisors Inc. Gamco spun off Teton, with Gabelli himself retaining 51% ownership and managing its micro-cap fund, Mighty Mites. CEO Galluccio would own 20% and focus on small caps. Like Gamco, Teton is publicly traded. Its thinly traded Pink Sheets shares recently traded at \$50, up from \$2.75 when Gamco spun it off in 2009.

Galluccio screens for companies with market caps between \$300 million and \$3 billion in four categories: turnarounds, undervalued growth, undervalued assets and emerging growth. Like most other value investors, he insists on meeting with CFOs and CEOs.

In this underfollowed area of the market, gaining an information edge is everything. To this end Galluccio's small team maintains a proprietary database on companies it has researched over the past 20 years. They knew, in October 2016, to pounce on Electro Scientific Industries, a Portland, Oregon, manufacturer of flexible printed circuit boards used in smartphones: Michael Burger, a skilled turnaround artist they had backed as CEO of another small cap, Cascade Microtech, had just joined the company. "He took costs out [of Electro] and created enormous—lean—lean management, you know, across the organization. Then the orders started picking up. The operating leverage was huge," says Galluccio. "The stock went from 5 to 20, like, immediately. That's what happens in small-cap land."

For a company to become one of the 80 or so holdings in Galluccio's portfolio, he must see a catalyst on the horizon. Takeovers are

common, especially by private equity firms flush with capital. "Many of the valuation metrics that we employ in our analysis are the same ones used by private equity," he says, adding that 29 of his portfolio companies have been taken over since 2012. "There has been major consolidation in the tech supply chain. These companies have a lot of cash, no debt, they buy back stock and pay good dividends."

In Galluccio's undervalued-assets category, regional banks are a fertile area for new buys. His biggest holding is Legacy Texas Financial, a \$9 billion (assets) bank that was tarnished (unfairly, he believes) when energy prices dipped in 2017. Teton bought in at \$18. The stock trades for \$40 today. Another undervalued-asset play is Houston oilfield-services firm Patterson-UTI, which Galluccio says sells at about half the replacement value of its rigs. Other picks include Hartford's United Financial Bancorp, an East Coast regional with \$7 billion in assets selling at 1.4 times book value, and New Jersey's Oritani Financial, which pays a 6% dividend. "There's going to be more consolidation in banks," says Galluccio. "There are too many."

Galluccio's biggest challenge these days is injecting some of his own stock-picking DNA into Keeley Asset Management, an underperforming Chicago-based firm Teton bought last year after Keeley's CEO unexpectedly died from a blood clot. "We now have collaborative research meetings with them weekly. It's injecting new life into the thinking," says Galluccio. "After a decade of growth outperforming, value is coming back." *

Nicholas Galluccio is the President and Chief Executive Officer of Teton Advisors, Inc., the investment adviser to the TETON Westwood Mutual Funds.

Individual securities mentioned are not representative of the entire portfolio. The views expressed in this article reflect those of the Portfolio Manager only through July 23, 2018 and are subject to change at any time based on market and other conditions. Stocks are subject to market, economic and business risks that cause their prices to fluctuate. Small capitalization stocks are subject to significant price fluctuations and business risks. The stocks of smaller companies may trade less frequently and experience more abrupt price movements than stocks of larger companies; therefore, investing in this sector involves special challenges.

As of June 30, 2018, the TETON Westwood SmallCap Equity Fund held the following as a percentage of net asset value: Patterson-UTI Energy, 2.0%; Ethan Allen Interiors, 1.6%; United Financial Bancorp., 1.1%; Meredith Corp., 1.0%; Extreme Networks, 0.8%; Hemisphere Media Group, 0.5%; and Mueller Water Products, 0.8%. When you sell Fund shares, they may be worth less than what you paid for them. As of June 30, 2018, the TETON Westwood Small Cap Equity Fund Class I returned 18.9%, 13.4% and 10.6% for the annualized 1-, 5-, 10-year periods, respectively, compared to 17.6%, 12.5% and 10.6% for the Russell 2000 Index and 13.1%, 11.2% and 9.9% for the Russell 2000 Value Index. As of the prospectus dated January 26, 2018, the TETON Westwood Small Cap Equity Fund Class I had a gross operating expense ratio of 1.49% and a net operating expense ratio of 1.00%.

Returns represent past performance and do not guarantee future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so, upon redemption, shares may be worth more or less than their original cost. To obtain the most recent month end performance information and a prospectus, please call 800-GABELLI or visit www.tetonadv.com

Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before investing. The prospectus, which contains more complete information about this and other matters, should be read carefully before investing. To obtain a prospectus, please call Teton Advisors, Inc. at 1-800-GABELLI or visit www.tetonadv.com. Distributed by G. distributors, LLC., a registered broker-dealer and member of FINRA. One Corporate Center, Rye, NY 10580.

For more information and a prospectus, visit our website at www.tetonadv.com or call:
1-800-GABELLI • 914-921-5100 • Fax: 914-921-5118 • info@tetonadv.com