# Best small company CEOs

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Australia's 30 best-regarded chief executives of small- and mid-cap companies have collectively created billions of dollars of shareholder wealth and are well on their way to building tomorrow's blue-chip stocks. Their success shows that when it comes to picking outstanding stocks, an ability to read people is as important as reading balance sheets.

ARB executive chairman Roger Brown. **Photo: Jesse Marlow**

The *Weekend Financial Review* asked 10 small-cap fund managers and analysts to nominate their most admired CEOs, and to reveal how they spot the most outstanding executives.

ARB Corp executive chairman Roger Brown and OrotonGroup CEO Sally Macdonald received the most nominations. Four-wheel-drive parts manufacturer ARB has an average annualised 10-year total shareholder return of 18 per cent. OrotonGroup's five-year average annual return is 39 per cent; over three years it is 67 per cent. As other retailers moan about weak sales and the online threat, OrotonGroup has barely missed a beat.

Domino's Pizza CEO Don Meij was also chosen. In a fickle fast food market, its five-year average annual return is 23 per cent. Domino's has done especially well in the past three years because of its successful overseas expansion and ability to create value through innovation in the highly commoditised pizza market.

In resources, Perseus Mining managing director Mark Calderwood stood out. He took Perseus from an unknown $13 million gold explorer in 2004, to a $1.3 billion gold producer, and navigated the immense challenge of building a mine in west Africa.

OrotonGroup chief executive Sally Macdonald. **Photo: Louie Douvis**

These and the other CEOs selected show that the best small- and mid-cap leaders are hardly household business names, even though their companies have produced consistent double-digit shareholder returns in good and bad markets.

Typically, these CEOs focus on building business first and creating wealth second, they often have an understated approach that lets company performance speak for them, and have a lower profile – given small and medium- size stocks have less of a following in the media and investment community. Not all of them follow this script, but it is fair to say these CEOs have less sizzle and more substance.

Their success shows why leading fund managers are almost obsessive "people watchers". Veteran investors know a top CEO can add a significant premium to a small-cap share price, including as much as two to four extra points of price-earnings multiple, which can be worth tens of millions to a company's valuation.

Prominent fund managers such as Wilson Asset Management chairman Geoff Wilson study how CEOs respond to questions and look for other clues about their ability, motivation and integrity. Wilson puts the same question to a CEO for years, and watches if the answers change as company performance changes and the strategy becomes muddled.

Domino's Pizza chief executive Don Meij. **Photo: Glenn Hunt**

Others, such as Montgomery Investment Management's founder, Roger Montgomery, believe that numbers tell more about CEO performance. He studies a company's return on equity and capital structure over long periods, and closely watches when CEOs sell their shares.

Small investors, of course, do not have the same access to CEOs as fund managers and analysts. But all investors can take simple steps to put management through the wringer.

Collating five to 10 years of directors' reports and seeing if management delivered on promises is as good as any indicator. With a bit of hard work, any investor can decide if a small-cap CEO has some or all of these characteristics:

The chief enthusiast

BT Investment Management's head of smaller companies, Paul Hannan, looks for CEOs who live their business and product, and use their passion to create shareholder value.

Domino's Don Meij is a good example. "He worked his way from the shop floor to managing director and turned the Australian business into one of the most profitable and successful Domino's global franchises," Hannan says. "A strong understanding of the business and its customers has underpinned significant product innovation and global expansion."

Reckon managing director Clive Rabie. **Photo: Louise Kennerley**

Hannan says Domino's is at the forefront of pizza ordering and delivery technology, and that the market is badly undervaluing its European operations.

Hannan also nominated Super Retail Group CEO Peter Birtles. The auto accessories and outdoor equipment retailer has a five-year average annual return of 17 per cent. Birtles' big test is convincing the market, by delivering big efficiency gains, that Super Retail did not pay too much with its $610 million acquisition of Rebel Group last year.

Early signs are promising but Birtles has a huge challenge to show the acquisition will be a company-maker in a weak retail market.

The visionary

SmallCo Investment's Rob Hopkins favours CEOs with great attention to detail. He worries when small-cap CEOs are great with words but less confident with detailed numbers in fund manager meetings. "We like CEOs who understand their industry, where their company fits in and how they make money from it," Hopkins says.

His top small-cap leader is Peter Dunai, the founder of investment technology group Iress Market Technology and now its non-executive chairman after retiring as managing director in 2009. Iress's 10-year average annual shareholder return is 15 per cent, a strong performance given sharemarket cycles affect demand for its products.

Perseus managing director Mark Calderwood. **Photo: Erin Jonasson**

Hopkins says: "Peter Dunai had great vision for his industry a long time before others, and made Iress a sales-focused, customer-responsive company. He was always very good at explaining the numbers and performance." The present managing director, Andrew Walsh, has a similar approach, Hopkins says. "It's the mark of a good CEO to have strong management continuity when they stand down."

Hopkins also likes the early work of new Skilled Group CEO Mick McMahon, who he believes has the focus on details and numbers that Skilled needs.

Long-term operator

Many mining CEOs are great at selling their company's story, and others create value by buying and selling projects. Canaccord BGF Equities executive chairman Warwick Grigor prefers mining CEOs who focus on operations rather than doing deals.

The resource analyst says: "Too many investors think a CEO is a good operator because they do a clever deal. But a CEO's long-term operating ability is far more important. Backing good management should not be a punt on their ability to do speculative deals."

Grigor likes mining CEOs with enough big company experience to know how to develop an asset, but not so much that they are inflexible in an entrepreneurial venture. Their record is important. Exploration failures are inevitable, although Grigor is more concerned when a CEO has led a moribund company that was afraid to explore and hoarded cash to pay directors' salaries.

Monadelphous chief executive Robert Velletri. **Photo: Tony McDonough**

He is especially cautious when the CEO is the company's promoter, which often happens in small resource floats, and prefers a CEO to own no more than 10 per cent of the enterprise.

Performance-based options targets linked to operational milestones, such as delivering a resource, are an attraction, Grigor says. Most options plans in small explorers are based on price targets, which encourage share price manipulation.

Grigor also looks for CEOs capable of growing with their company as it moves from exploration through feasibility studies and into production. Perseus's Mark Calderwood is an example.

Other top resource CEOs that Grigor selected include: Ampella Mining's Paul Kitto; Buru Energy's Eric Streitberg; Adamus Resources's Mark Connelly (Adamus merged with Endeavour Mining late last year and Connelly is now chief operating officer); Saracen Mineral's Guido Staltari; and the team of chairman Nick Giorgetta and managing director Mark Clark at the well-performed Regis Resources.

Customer-focused

Perennial Value Management's head of small companies, Grant Oshry, looks for CEOs who are "very good at what they do, understand industry dynamics, have a clear strategy and, most importantly, understand who their customers are and what they want". He chose OrotonGroup's Sally Macdonald, TGP Telecom founder David Teoh and NIB Holdings's Mark Fitzgibbon as being among Australia's most customer-focused small-cap CEOs.

TPG's three-year average annual return is 134 per cent. Oshry says: "TPG has grown from humble beginnings under the impressive leadership of founder David Teoh. His strategy is clear and his focus on giving customers quality products at good prices is reflected in TPG's strong subscriber growth numbers. Owning 37 per cent of the company ensures Teoh's interests are aligned with all stakeholders, and the company has a disciplined cost approach."

Oshry likes NIB's customer-value strategy. He says CEO Mark Fitzgibbon is focused on increasing the number of policyholders, and using multiple distribution and online channels to attract customers. He likes that NIB, like OrotonGroup, has avoided potentially overpriced acquisitions and looked at incremental ways to lift profits, paid good dividends, and returned capital to shareholders.

The motivated

Wilson Asset Management's Geoff Wilson pays great attention to a CEO's honesty, ability and drive. He carefully examines their record and tries to understand what motivates them. "We look at how old the CEO is, how long they will stay with the company, and how much they have riding on its success. There is no standard formula, but we like CEOs who are really determined to prove themselves in a company and have very strong, clear motivation."

Wilson says the best small-cap CEOs are often the most understated, and says Reckon managing director Clive Rabie is a good example. The accounting software group has a 10-year average annual shareholder return of 37 per cent. "Reckon has delivered for our fund for over a decade," Wilson says. "They just go about their business and manage the company like you would want it managed, with a tight cost structure and always looking to add value for shareholders."

Wilson names McMillan Shakespeare boss Michael Kay and ARB's Roger Brown as other standout small-cap CEOs.

Long-term performer

Celeste Funds Management's Frank Villante favours CEOs who perform during different industry cycles. Retailing is an example. Some CEOs looked like stars when retail conditions were stronger last decade, but have underperformed in subdued markets.

Many CEOs of mining services companies appear exceptional in the middle of a resource investment boom, but will be tested when an inevitable slowdown leaves them with expensive, depreciating equipment sitting idle.

Villante pays great attention to a company's board, governance and transparency, and the quality of its accounting. He nominates Monadelphous CEO Robert Velletri as a top performer. The mining services group has a stunning 10-year annualised total shareholder return of 53 per cent.

"Monadelphous's management team has very distinct operational strengths in engineering, and deep customer relationships built over 20 years," Villante says. "It also had very clean financial accounts and an exceptional, consistent return on equity. You are prepared to pay a little more for a company when it has that type of long-term performance."

Of other small caps, Villante believes GUD Holdings' Ian Campbell deserves more recognition, given his work in remoulding a diversified business in tough markets. Villante also rates executive teams at SMS Management and Technology, DuluxGroup, and Austbroker Holdings.

The communicator

Montgomery Investment Management's Roger Montgomery and its portfolio manager, Russell Muldoon, look for CEOs who can communicate clearly to investors. Muldoon says: "If a CEO can't communicate clearly to the market, they won't communicate clearly to their staff or customers. We look for CEOs who can explain their strategy, have lots of energy and intelligence, and are honest. That type of CEO, and a business in a sweet spot, creates valuable competitive advantage."

Montgomery says published accounts tell the best story about the small-cap CEO performance. "We look for a high return on equity sustained over long periods, low or no company debt, and strong cash flow." Montgomery also likes CEOs who pay for their shares rather than only receive them through options plans – and is especially concerned when executives sell shares before capital raisings.

He and Muldoon nominated Decmil Group CEO Scott Criddle, ARB's Roger Brown and OrotonGroup's Sally Macdonald as some of Australia's top small-cap CEOs. Fleetwood Corp executive director Greg Tate has also impressed.

The interpreter

As an investor in emerging life science companies, NAOS Asset Management's Sebastian Evans spends much time looking at a CEO's record in building start-up companies and who they attract to the board and senior management. He favours biotech CEOs who can explain the science and the market potential. Too many life science CEOs, he says, are "great at selling the science but are not nearly as good on the market and numbers".

Evans says REVA Medical is a well-run life science company. The US medical device company raised $85 million and listed through a December 2010 float. Executive chairman Bob Stockman has built several successful life science companies, and the REVA board attracted Anne Keating and former Citigroup Australia investment banking chief Rob Thomas.

REVA's $1.10 issued shares have fallen to 56¢ since listing, partly because of research delays and a weak market for speculative companies. But Evans knows life science companies are long-term investments that can provide thrills and spills. Evans says Richard Treagus, of Acrux, is another outstanding CEO.

The people leader

Angus Geddes, CEO of Fat Prophets, says small-cap investors sometimes overlook the value of leadership and culture, believing these factors are more important in big companies. He seeks small-cap CEOs who develop several leaders and build and maintain great organisation cultures as the venture grows rapidly. He says low executive staff turnover, a stable board, CEO appointments from within the company, and positive relationship between the chairman and CEO are signs of strong leadership.

"You often see small-cap managers who are very intelligent and full of energy but don't have great interpersonal skills," Geddes says. "They simply cannot put teams together, motivate them and get everybody moving in the same direction."

Geddes says leadership qualities come to the fore in acquisitions. "CEOs are ultimately capital allocators, and the good ones are able to make acquisitions and deliver shareholder value by bringing different teams together." Geddes says IOOF Holdings's Chris Kelaher is a good example of a CEO who uses leadership skills to deliver value through acquisitions, and also nominates Magellan Financial Group CEO Hamish Douglass for his leadership qualities.

In resources, Geddes rates Evolution Mining's executive chairman, Jake Klein, and its retiring managing director Bruce McFadzean for their work in merging Catalpa Resources, Conquest Mining and buying certain Newcrest assets. Gold Road Resources executive chairman, Ian Murray, is another who has over-delivered on exploration promises, Geddes says.

The contrarian

Small-cap CEOs can easily spend a third of their time dealing with investors. Some get captured by the process and manage the company to please the market, rather than create long-term shareholder wealth. Or they are too easily swayed by investment bankers' suggestions to lift the share price.

Intelligent Investor research director Nathan Bell nominates Servcorp founder Al Moufarrige as a top small-cap CEO, even though shares in the serviced offices provider have struggled over five years.

Bell says: "Rather than chase growth in boom times, Moufarrige ignored the siren song of investment bankers calling for Servcorp to optimise a lazy balance sheet by taking on more debt. Instead, he waited patiently for the downturn to reduce office rents around the world, enabling Servcorp to expand at a much lower cost, to increase profits. That's the type of contrarian manager we look for."

Bell adds: "There's net cash on Servcorp's balance sheet, which protects it from inevitable cyclical downturns and allows it to pick up market share. Servcorp has also paid out special dividends, suggesting it is shareholder-friendly. And Moufarrige has a large stake in the business and is prepared to buy more shares on the open market."

The Australian Financial Review

Super Retail Group chief executive Peter Birtles. **Photo: Glenn Hunt**

GUD managing director Ian Campbell. **Photo: Arsineh Houspian**

Ampella Mining's Paul Kitto.

Decmil chief executive Scott Criddle.