



Leah Zell and Russel Pillemer are due to collaborate. PHOTO: COLE BENNETTS

When small outplays big on a global stage

Winning duo Queen of small caps, Leah Zell to partner Russel Pillemer.

Jonathan Shapiro

To buy Indian equities in 2014 – which are up 30 per cent to date – required remarkable foresight. But it didn't require a wheelbarrow.

Things were different in the early 1990s when Leah Zell, a pioneer of

international small caps, first bought Indian stocks.

"They got delivered in wheelbarrows in hard copy and we had to ship them to the company registrar, who in typical Indian bureaucratic fashion had to stamp each and every stock certificate," she told *The Australian Financial Review*. "And we got 10 per cent of them being rejected for being counterfeited."

India and global markets have come a long way in the past 25 years but so too
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When small outplays big on a global stage

has Zell, who has established herself as the queen of international small cap investing.

She was the co-founder of Wagner Asset Management, the pre-eminent name in global small caps that forged a trail and grew to manage billions of dollars. When she sold the fund in 2000 to Liberty Mutual, it was a young Goldman Sachs banker named **Russel Pillemer** that advised her on the deal.

And when Pillemer set up investment firm Pengana Capital in Sydney, it was Zell's business model that served as his blueprint.

"We started with small caps. We loved it because of them and our structure – of autonomous fund by high quality managers – is based on what these guys have done," Pillemer told *The Australian Financial Review*.

Zell, who now oversees the Lizard Investors fund she formed in 2008, was in Sydney this week to re-establish a partnership with Pillemer. Pengana will offer Lizard's small caps fund in Australia where demand for foreign equities among self-managed super funds is rising. The fund will invest in 30 to 80 global companies with market capitalisations under \$10 billion.

Zell, who is the younger sister of real estate mogul Sam, oversees Lizard Investors from Chicago. She is evangelical about small cap investing which she says is "one of the last refuges where one should pay for active managers".

Global large caps, Zell advises, can be managed from home. For small caps she says it's more a case of 'do not try this at home'.

"Everyone needs to be somewhere but O'Hare [airport] is about as good place as any to get to Asia, Europe and Latin America. Every place is about eight hours away," she says.

Last month she spoke at the prestigious Sohn London conference where she walked investors through one of her high conviction investments – a stake in a Polish debt collection agency "Kruk". Her opening slide showed an image of a Tiffany's Jewellery box "to remind everyone that value and size can be inversely related".

But Zell says there are structural forces at work that took hold after the global financial crisis which add to the advantage of investing in small caps. More institutions are allocating to

larger investment funds that in turn are limited to investing in large companies that can absorb their investments.

"You have had concentration of both allocators and managers. There are more and more dollars going into the Apples, Mastercards and Nestles of the world," she says.

Large companies may appear impenetrable to outsiders and themselves, but that is often what makes them risky. "Trees don't grow to the sky" is one of Zell's mantras.

One emerging theme that typifies the risks of large cap stocks and the opportunity in smaller companies is one that local investors in retail giant Woolworths are coming to terms with – the rise of "hard discount retailers".

Zell says the fund has done a lot of work in the space. The two largest players are privately owned German firms Aldi and Lidl.

"They are very, very good and they

The end game for lumbering large caps could be oblivion

Leah Zell

really are turning the industry on its head," she says.

One may not be able to buy shares in these unlisted companies, but Zell is buying into those with similar business models in Turkey, Israel and Japan.

"It's a case of 'I've been to the movie'. I know the metrics, I know the gross margin and where it should go as they get scale. I know if they are starting in Tokyo or Tel Aviv they're not going to work, because you have to start outside of the big metros areas to get the scale to be able to get your cost structure in line to eventually assault in the metros. There's a pattern as to how these work."

Zell calls these firms innovative disrupters, as described by Harvard Business School professor Clayton Christensen.

"He's codified something we have known for a long time – which is that established companies become prisoners of their own success".

The end game for lumbering large caps could be oblivion.

"It reminds me of Ken Olson's famous statement: 'are people really going to have computers in their homes?' He was the head of one of the largest American computer firms – Digital Equipment Corporation, DEC – and who remembers them?"