

INVESTOR'S BUSINESS DAILY

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MUTUAL FUNDS

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Managers Track Trends To Big Stakes

Keep Eye On Valuation

Buffalo Mid Cap favors health care, technology and business services

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FOR INVESTOR'S BUSINESS DAILY

To a lot of investors, the financial world probably looks a lot different than it did just a few weeks ago thanks to the subprime mortgage mess. But that's not the case at \$437 million **Buffalo Mid Cap Fund**.

The portfolio^{BUF} has beaten its benchmark, the Russell Mid Cap Growth Index, since inception in 2001. And despite all the hullabaloo on Wall Street of late, it's same-old same-old for managers Robert Male, Grant Sarris and Kent Gasaway.

So far this year, the fund was up 12.46% going into Wednesday vs. 10.85% for mid-cap growth funds tracked by Morningstar and 5.09% for the S&P 500.

"We have a weighting in financials," Male said, "but it's in financials that are more asset-management based, fee-generating businesses instead of the spread businesses. They were hit, but they weren't hit as hard. Things like Janus^{JNS} and T. Rowe Price^{TROW} primarily own equities, not some derivative or security that can't be priced."

In other words, the Buffalo team likes to have a good handle on risk.

They are growth managers and they like great earnings

as much as the next guy. Median earnings growth for the companies in the fund typically has been in the mid-teens the past few years, a few points better than median revenue growth.

But by being a bit valuation sensitive, the managers figure they can generate solid returns without taking on a ton of risk. The fund's average forward price-earnings ratio is a rich but not outrageous 23.

"We try to buy companies that have high-quality balance sheets," Sarris said. "And therefore, when there is a lot of uncertainty, we're not worried about whether or not companies can pay off their debt or if they might need new financing and what rate that new financing might have to come at."

First Things First

The initial step in the Buffalo investment process is identifying big-picture trends. Right now, the team has spotted almost two dozen of them, including the international growth of U.S. brands, Internet commerce, corporate outsourcing and health care cost containment.

Then the team figures which firms are beneficiaries of those trends and begin a bottom-up analysis.

Key criteria there include strong revenue growth, little or no debt, an ability to consistently generate free cash flow, high profit margins, a proven management team and scalable business mod-

Buffalo Mid Cap



Bob Male



Grant Sarris

■ Load: None
■ Expenses: 1.02%

Total returns as of 9/11/07

2006: 5.70% 3-yr. avg.: 15.76%
YTD: 12.46% 5-yr. avg.: 17.21%

Source: Morningstar Inc.

Sector weightings as of 6/30/07

	% of stock assets	Rel. to S&P 500
Information	26.96%	
Software	10.40	2.83
Hardware	13.85	1.33
Media	2.71	0.84
Telecom	0.00	0.00
Service	59.22	
Health care	25.03	2.14
Consumer services	18.44	2.43
Business services	7.83	1.91
Financial services	7.92	0.39
Manufacturing	13.81	
Consumer goods	8.11	0.96
Industrial materials	5.70	0.46
Energy	0.00	0.00
Utilities	0.00	0.00

els that can be applied to broad regions and markets.

The fund's makeup is as consistent as its performance. The focused fund holds 50-70 stocks, with 54 at last check.

Median market cap is about \$5 billion. With annual turnover of just 22%, the names are pretty much what they were six months ago, save for a few buyouts such as A.G. Edwards and Penn National Gaming.

Same goes for sectors. Health care, tech and consumer services make almost 70% of the fund's assets.

One favorite is Morningstar^{MORN}. The fastest growing part of its business, up 68% during last quarter, is serving as a consultant to asset managers and advisers, getting paid a percentage of the assets they consult on.

"That's a very scalable business," Male said. "And you could also argue the company benefits from

e-commerce because a huge portion of their business is done on the Web."

In health care, the managers like Amylin Pharmaceuticals^{AMLN}, which develops next-generation drugs for diabetes, even though it's losing money.

"We're a big believer in diabetes control and that drugs for diabetes are going to be huge growers over the next 10 years," Sarris said.

At about 8% of assets, the fund is overweighted in business services, which include Iron Mountain^{IRM} and ChoicePoint^{CPS}. "We're not buying companies that rust or smokestack," Sarris said.

Sarris is upbeat about the fund's prospects. "We feel it's developing into the kind of market where, with the economy slowing a bit, true secular growth companies are becoming more in favor over value, deep cyclical names, which could benefit us."