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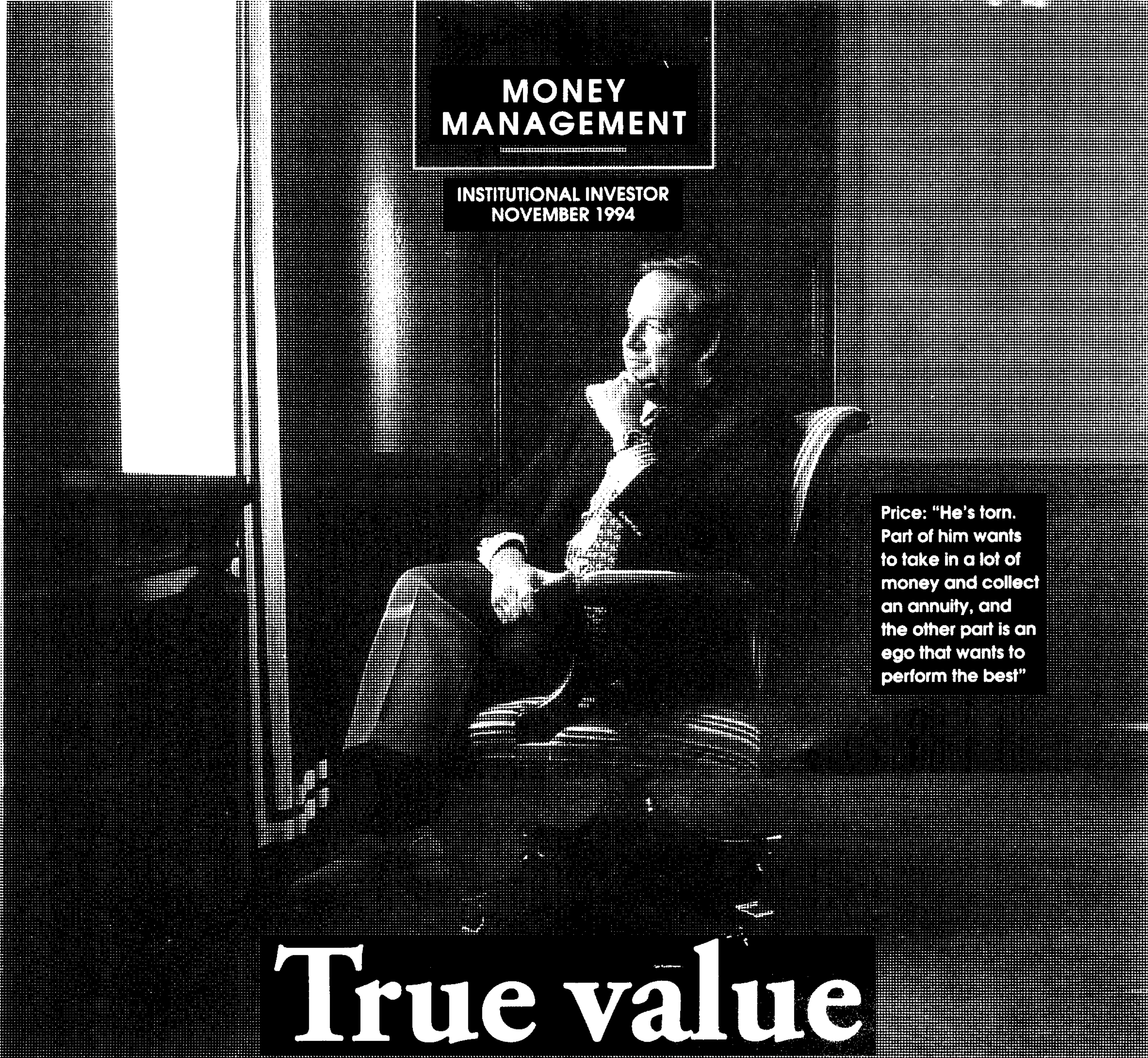


Price: "He's torn. Part of him wants to take in a lot of money and collect an annuity, and the other part is an ego that wants to perform the best"

True value

photos by Gary Spector

Mutual Shares' Michael Price has made billions for himself and his clients by buying value. But as his funds grow, will performance suffer?

By Alyssa A. Lappen

Some investments take a long time to ripen. And Max Heine, a German Jew who fled Hitler's Berlin before the Nuremberg laws were passed, was a patient investor. In 1949 Heine set up a no-load mutual fund called Mutual Shares in a modest office on Broad Street in Manhattan. His original investors were fellow refugees, family and friends. Heine ran up monumental returns on their behalf from such legendary bankruptcies as the Penn Central, Boston & Maine and Reading railroads, decades before investing in distressed securities became fashionable.

But Heine's most important investment was an even longer-term bet — on the financial education of a kid named Michael Price, the son of a client. Price joined Heine Securities in 1975, little more than a year out of the University of Oklahoma. The young man had lacked academic sparkle but took to investing under Heine's old-world tutelage as to no subject he had studied in school.

Price was just 37 when his mentor was struck and killed by a car in 1988. But as Heine's right-hand man, he had already helped build Heine Securities from a firm with a single $5 million fund when he joined to one with three funds and $2.5 billion under management when Heine died. And the firm, which Price bought, has kept right on growing. Today Price runs more than $8.5 billion in four Mutual Series funds, the Bermuda-based Orion Fund and separate accounts for the Common Fund and Yale University.

The question now: How big can Price's funds grow before performance suffers?

Unlike growth at many other funds, the recent increase in Price's assets under management is thanks mainly to his phenomenal returns, not to new sales. This year, in an environment that has severely pounded well-regarded hedge fund managers such as Michael Steinhardt and George Soros and left many mainstream equity managers outpaced by money market funds, Price's four U.S. funds have racked up handsome gains of between 5.9 and 7.6 percent.

Price's long-term record is just as sound (see box below). In the three years ended September 30, Price's flagship $3.8 billion Mutual Shares fund returned an average of more than 16 percent annually, and his $1.95 billion Mutual Beacon and $1.7 billion Mutual Qualified were both up roughly 18 percent a year — despite cash positions of between 11 and 14 percent in each. Meanwhile, the fully invested $760 million small-cap Mutual Discovery fund has returned 45 percent since its launch in January 1993.

Price's clients, which range from FMC Corp. to the Boston Symphony and the Sioux Falls South Dakota Retirement System, are enthralled. "Michael Price is one of those phenomenal stock pickers," says Stephen Eckenberger, a vice president of the Common Fund, whose $80 million separate account with Price returned an average 26 percent a year for the two years ended August 31. "He has much more than doubled the return of the Standard & Poor's 500 over two years, and over one year he has tripled the S&P."

That's impressive, even to people who are hard to impress. "His investors are among the savviest people in business and finance," says a trustee of a New England college (not Yale) that invests with Price. "Captains of industry and very famous people who run big financial institutions all populate his funds with the same degree of confidence that I do."

Salomon Brothers Asset Management chairman Robert Salomon Jr., for example, has been investing alongside Price and in his funds since meeting him in 1980. "I'm a big fan," says Salomon. Another fan is value player Mario Gabelli, who has money in Mutual Discovery. "He's excellent," says Gabelli. "He has a real niche."

Stocks for free

Ask Price how he learned his craft and without hesitation he says, "Max," with a drawn-out inflection and a wave of the hand suggesting that the name explains everything. The lesson Price learned from Heine, and further refined himself, was how to buy $1 worth of assets for 50 cents. "I learned how to work on what's cheap," Price explains. "I became a total believer. To this day I think that is the only way to invest." Price often talks of buying stocks "for free" — in other words, finding two or more assets for the price of one and making sure there's very little downside risk. "What makes him great," says Salomon, "is that he was buying, long before it was popular, bank loans and other securities of bankrupt companies."

Just as Heine did, Price invests 20 to 30 percent of his funds in corporate restructurings of all sorts — not just bankruptcies — and 10 to 20 percent in cash (the rest is invested in traditional value plays). "Roughly half the assets don't move with the market that much but rather with the progress of deals, bankruptcies, liquidations, tenders, sales of assets and buybacks," he explains. "That's why the funds tend to go down less than the market [in a bad year] and go up less [in a good one]."

Take Seagram Co.: Mutual Series owns more than 602,300 shares of the Canadian liquor giant, worth more than $18 million in today's market. Price began buying more than a decade ago when Du Pont beat Seagram in a bid for Conoco (in which he already owned a stake). He's still buying on declines.

"Seagram wound up owning 24 percent of Du Pont," he says. "From that day on Seagram was an interesting stock; you could buy Du Pont cheaper by buying Seagram. If you back out the Du Pont shares, you're still paying the lowest price for the best liquor company in the world — better than Guinness, better than Allied-Lyons." Seagram is trading at a one third discount to asset value, Price notes, adding that there are still nine ways to make money on the stock.

In the early years Price worked the phones across the desk from Heine. He loved figuring out details that other

Price and performance

Ask Michael Price, chairman of Mutual Series (story), why he underperformed the value index in 1990 and he retorts, "I don't know what the value index is." Price has very little use for performance measures other than the Standard & Poor's 500 index. He's even more disdainful of quantitative models that purport to assess his style based on his returns.

Last year Price received a questionnaire from West Coast consulting firm Barra — and chucked it straight into the wastebasket. "It just didn't apply to us," he says. "I don't care about the P/Es of stocks I buy. Dividend yield has nothing to do with what we do here. How do you fit a Canadian real estate developer's defaulted bond into a quantitative model? I mean, give me a break."

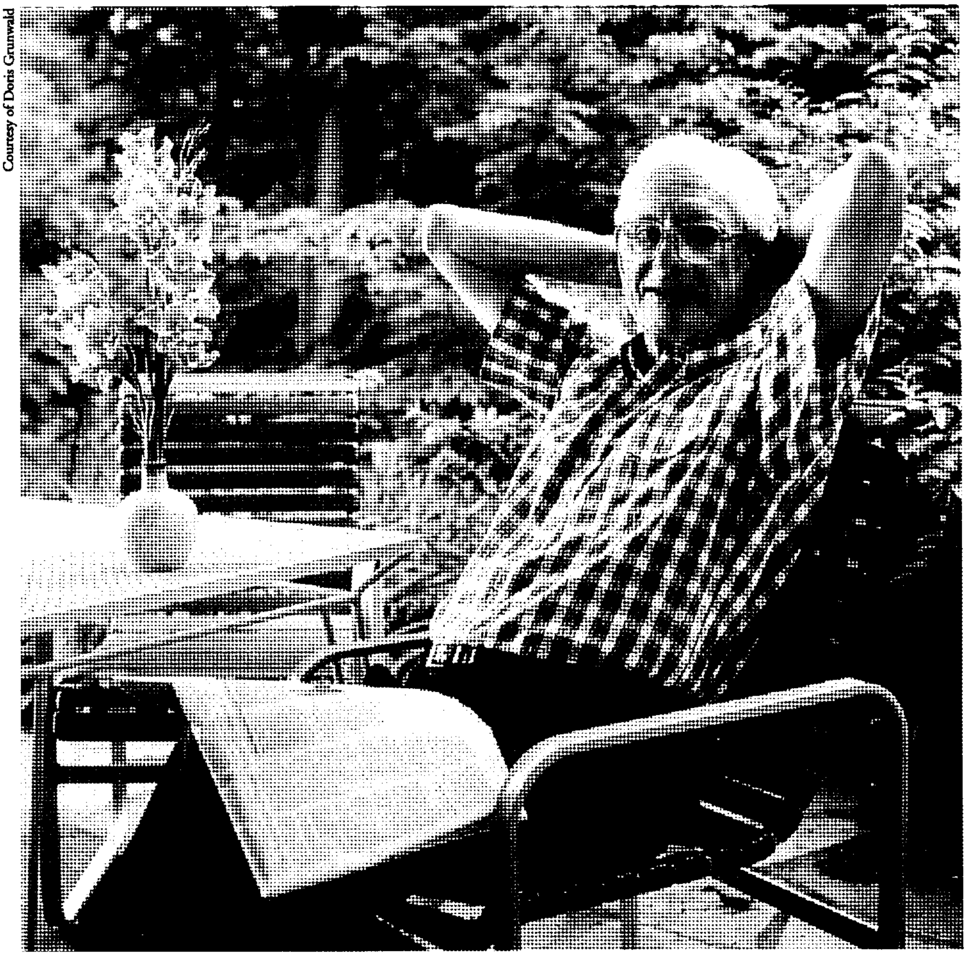
Here are the annual average total percentage gains of Mutual Shares' four funds — measured against the S&P.

	One year	Three years	Five years	Ten years
S&P 500	3.68%	9.16%	9.12%	14.58%
Mutual Shares	9.82	16.29	10.52	15.22
Mutual Qualified	11.83	17.79	11.29	15.66
Mutual Beacon	12.38	18.11	11.65	15.75
Mutual Discovery	18.88	*	*	*

* *Not applicable.*

Source: Lipper Analytical Services.

investors were too lazy to spot. "I kept to a very few stocks — well researched, bought cheaply — rather than things that were followed by everyone and traded at market multiples," he says.


Courtesy of Doris Grunwald

Heine: He taught Price how to buy $1 worth of assets for 50 cents

Price was remarkably creative. In 1976, for example, news came across the wire that Thomas Mellon Evans, Pittsburgh takeover king and chairman of Crane Corp., had bid for Fansteel. "I ran across the street to the New York Stock Exchange library, swapped dollars for quarters and copied the annual report. It seemed Fansteel was involved in refractory metals — including tantalum, tungsten and molybdenum — which were used to harden steel. I wondered why Evans was buying this company, so I grabbed the New York City Yellow Pages just to see if anybody sold tantalum. Sure enough, there was a company called Tantalum Co. of America."

Price gleefully recounts the huge rewards he reaped from a cold call to Tantalum. An anonymous employee told him that the price of tantalum had gone through the roof and suggested that he also look at Kawecki Berylco, which had a Baltimore warehouse full of the stuff. Price immediately bought both Fansteel and Kawecki; the latter's shares promptly soared from 9 to 40. Research on Kawecki then led Price to International Mining, which owned nine specialty metal plays that Price also picked up — including Rosario Resources, a gold company called Pato, a Mexican silver mine called Fresnillo and exotic-mineral producer Molycorp. International Mining nearly tripled when it was later taken over by David Murdoch, and Molycorp was sold very profitably to Union Oil.

On-the-job training

Today, at Heine Securities headquarters in Short Hills, New Jersey (Price moved the firm from Manhattan in 1988), ten junior analysts tap into a host of computerized databases providing instant information. But the firm's style remains the same. "I'm trying to do the same thing in 1994 that we did in 1975 investing $5 million, only a little bit bigger this time," says Price. "In the old portfolios [of the '50s], you'd see Cuban railway bonds, companies in liquidation, companies in mergers and closed-end funds at discounts. We own the same kinds of things today. Now, sure, we own names like Eastman Kodak and Sears and American Express, but we own them because the companies are restructuring."

Price watches the market carefully, religiously deepening his positions on price dips. Few details escape him. "Mike is like one of those 19th-century accountants you'd picture working with an eye visor and a pencil tucked behind his ear," says Michael Hirsch, head of the M.D. Hirsch division of Republic Asset Management, whose clients have more than $5 million in the funds. Typically, Price owns 250 to 300 positions and has between 80 and 90 buy and sell orders with brokers. "On every stock we own," he emphasizes, "I and the analyst know where we buy it and where we sell. So you get a down day in the market, 5 or 10 percent, a real slaughter, we've got to be out there buying." Trading in and out of a stock is strictly verboten.

Price subjects his analysts to the same intense on-the-job training Heine gave him. In 1991 analysts Susan Potto and Gregory Gigliotti proposed buying waste hauler Browning-Ferris Industries. Price blanched. "You have 30 seconds or less to justify discussing a high-multiple, high-growth stock that we would normally never own," he snapped. Gigliotti quickly rose to the challenge, noting that Browning-Ferris's price-to-cash-flow ratio was only one third that of rival Waste Management. Before Gigliotti even got to the value of the franchise, Price was on the phone to his local trash hauler, who explained the lock Browning-Ferris had on its markets. Price bought Browning-Ferris at about $18 a share and sold a year later at about $26.

Clearly, Price is not a patient boss. One new recruit on the foreign stock desk recently made the mistake of showing Price the 1997 earnings projections on several companies. "What are you doing?" Price barked. "Don't waste my time! Tell me what the company is worth *today*, based on reasonable multiples of cash flow or replacement values. Don't ever show me any 1997 numbers again. They're meaningless."

"Mike's a very quick study," says Edward Altman, Max Heine professor of finance at New York University's Stern School of Business and a member of the Mutual Series board. "But sometimes he doesn't have tolerance for people who aren't as quick."

Once the kids catch on, however, Price gives them free rein. Early last year, for example, Potto and Gigliotti toured Litton Industries with its managers and came away thinking that they could buy its defense business "for free." Litton then owned Western Atlas, a seismic surveying and industrial automating business that competed with industry giants Schlumberger and Ingersoll-Rand. The analysts figured that if this high-growth business traded independently, it would be priced at between eight and ten times cash flow. Says Gigliotti, "We knew how much cash they were generating, and we could see the quality of the assets."

Bingo. They added to a small stake in Litton at $45 per share, just a few months before it announced that it would spin off Western Atlas to shareholders. The two companies' combined share price subsequently rose to $83 a share. But Potto and Gigliotti were still dissatisfied with Litton's market value. They held onto Western Atlas and again doubled their stake in Litton, whose defense business they deemed likely to be a takeover target and whose pending $1.2 billion settlement in a case against Honeywell is worth $8 to $12 a share. Litton is now the second-largest holding of Mutual Qualified and Mutual Beacon and the third-largest of Mutual Shares.

Langerman: The ex-bankruptcy lawyer structures deals for Price

"This place rewards and encourages performance," says Peter Langerman, a Yale and Stanford University–educated bankruptcy attorney whom Price hired from New York law firm Weil, Gotshal & Manges in 1986. Langerman, who is now Mutual Series' executive vice president, clearly loves his job. "It's challenging and fun. We have unlimited opportunities. It's up to you to say, 'Here's what I found,' " he crows.

Langerman should know. He was Mutual Series' point man in the restructuring of Sunbeam-Oster Co., the consumer products company Price, together with Paul Kazarian's Japonica Partners and Michael Steinhardt in 1990, bought out of bankruptcy. For about a $60 million investment, Price's shareholders wound up with assets worth some $700 million.

Langerman also played a big role in the funds' huge position in Zenith Labs, a bankrupt generic drug company about to be bought out by health care giant Ivax Corp. for a large gain. "I'm always looking at new stuff," says Langerman. "There's not as much [distressed] merchandise as there was, but there's still a lot to do and a number of plays we are involved in" — Cadillac Fairview, Columbia Gas System, El Paso Electric and Trizec, to name a few.

No manager is continuously hot, of course, and Price is no exception. In 1989 and 1990 Mutual Shares, Mutual Qualified and Mutual Beacon all badly underperformed the market. Morningstar for three years consigned them all to the bottom quartile of the growth and income sector. In 1990 the funds skidded 9.8, 10.1 and 8.2 percent, respectively.

Things were so bad that Price himself wondered whether he had lost his touch. The miserable performance owed partly to his misguided participation in the 1986 leveraged buyout of retailer R.H. Macy & Co. "It's pretty ironic," says Price, who once did a stint as an assistant sportswear buyer for his father in a building just across from Macy's flagship New York store. "I used to go fight over nickels on ten dozen dresses or sweaters. I didn't like anything about selling, but I wound up on the board of Macy's."

Price bought a large stake in Macy's zero-coupon bonds very cheaply in 1986. If he had sold them when the LBO closed that same year, as did General Electric Asset Management, he'd have made a bundle. But he hung on into the top of the retail cycle in 1988 — and mistakenly supported Macy's bid for two divisions from Federated Department Stores. "I was wrong," he admits candidly. His total net loss on Macy's: more than $30 million.

Now that Price's performance has come roaring back, he is his old brashly confident self. Some investors feel the down years should have taught him a bit more humility. "He's come back," says one former investor. "But he's been very, very lucky. He got arrogant and, in a way, defensive. I saw these character changes, his puffed-up persona, and I wasn't going to leave my money there." Replies Price: "I have a lot of self-confidence, period. End of story. If someone was running $8 billion for me, I'd want him to be sure of himself."

For all the autonomy Price gives his staff, he remains the final arbiter. He does, after all, own the entire business, having bought the adviser to Mutual Series from Heine's estate in 1989 at a price previously worked out with Heine. But Price was running the business long before Heine died and had played a big role in expanding the firm by adding new funds.

He helped build Mutual Qualified in 1980 and took on advising (for free) Massachusetts-based Beacon in 1985 when a group of doctors approached Heine with their $6 million in assets. (The funds have similar investment strategies, but Qualified is geared to tax-free retirement accounts.) Price added the $100 million offshore Orion in 1990 and Mutual Discovery last year. It was also Price who kept costs down by introducing, in 1988, the series fund format, which permits one set of legal and administrative expenses for all the funds.

Another cost saver is that the funds sell themselves. "We don't advertise, we don't have salesmen, we don't spend a nickel marketing," boasts Price. "My view is, Get better performance and the money'll come in. Every week, you open *Barron's* and *The Wall Street Journal*, and Fidelity has all these ads. They have more than 16 percent of the [equity] mutual fund market, and we have 1 percent. Yet with no marketing, we get all this money in here — so much sometimes that we have to shut [the funds] down. Why? Because we do our homework and invest well." Price's only marketing costs are the printing and mailing of applications and prospectuses — which at the current rate of 800 per day probably amounts to only $300,000 a year.

Price (center) and his analysts: Rigorous on-the-job training

Handsome annuity

All this has made Price a very rich man. Investment bankers figure his company is worth between $150 million and $200 million. No one, and especially not Price, will say what he paid for it. Notes one observer, "Max gave this company away." But however small the sum, Heine's heirs are unconcerned. "We never thought about it," says Doris Grunwald, the eldest of Heine's three daughters. "It was my father's business." The family still invests with Price, and in their view he has simply been rewarded for his hard work.

That reward takes the form of a handsome, and growing, annuity. Total management fees amount to roughly $52 million a year — after brokerage, administrative and custodial fees. Even if this strict value disciplinarian takes only half of that in personal salary, it's easy to see how he maintains a mansion in Short Hills and the polo ponies he loves.

Heine, who was intensely loyal to his shareholders, always prided himself on keeping management fees and total expenses extremely low. But in 1990 Price raised management fees 20 percent, to 60 basis points, on the three biggest funds. And although still below average, overall expenses rose by one third. When Mutual Discovery was started up in 1993, its management fee was set at a rate that, given the growth in overall assets, Heine might have questioned — 80 basis points. "We did an excellent job, and we felt we were justified in getting an increase to add computers and personnel," says treasurer Edward Bradley.

These fee increases helped Price pay for Heine Securities' beefed-up legal and financial staff, a requirement imposed by the Securities and Exchange Commission when it censured Price's firm in 1988. Heine and Price had failed to properly disclose some $2.4 million in trading commissions they had earned off the fund from 1985 to 1987. At the time, they were also brokers for Herzog, Heine, Geduld, a securities firm whose interest in Heine Securities was sold to Max Heine in 1986.

Meanwhile, Price personally put up the money to establish Compliance Solutions, an independent company that funded the development of software that prevents violations of federal securities laws and internal guidelines — and is now being marketed outside through Merrin Financial. (Another SEC inquiry regarding some Macy's securities was dropped in 1992, and the firm has heard nothing more about an inquiry last year regarding heavy trading at Herzog Heine in Sunbeam-Oster warrants. "Mike doesn't have a malicious or criminal bone in his body," says one investor who knows him well.)

Investors are not complaining — thanks mainly to performance. Also, overall expenses have declined 10 percent since 1990 (although the head count at the firm has tripled, to 63, since late 1987). Of course, Price still actively watches costs. Last month, following the practice of other mutual fund houses — including Fidelity Investments and Merrill Lynch — Price opened a new brokerage firm called Clearwater Securities to trade securities for the funds and other clients. (Another key advantage: Price gets access to the trading floor.)

Price may profit from these trades, as he did from his brokerage seat at Herzog Heine. But as long as everything is fully disclosed, it's perfectly legal. And brokerage costs should fall, further adding to shareholders' returns.

Meanwhile, Price and treasurer Bradley are ecstatic because tens of thousands of Mutual Shares investors have shifted some $1.1 billion worth of fund shares to their accounts at discount brokerage houses Charles Schwab & Co. and Jack White & Co., apparently to benefit from the all-in-one financial statements they offer. Schwab and White thus assume all transfer-agent and back-office charges for about 13 percent of Mutual Series' assets, reducing costs for the funds.

"Price has lost more than a few protégés — some to hedge funds."

Future course

Price, although just 43, now faces a major quandary. "Other than picking stocks," he confides, "the big job I have is management succession, getting a group of people who can work well together when I'm around as well as when I'm not around." As one major shareholder puts it, if Price were, like Heine, tragically hit by a car, there would be a major run on the funds. Counters Price: "There's no way to predict how my top four or five people might work together if I'm not here. But the stage has been set."

Price is referring to Langerman, vice president Lawrence Sondike, banking and health care analyst Ray Garea and insurance analyst Robert Friedman. "They're terrific, senior and smart, and as a group they could manage this place," Price contends. "And there's another group of five terrific people following on their heels who are also fabulous," he adds with a laugh, clearly delighted with his handiwork. "It's a deep bench.

"I treat my top people like partners," Price continues. "They know that there is a chance that [if this company is] recapitalized, they can become owners [eventually]." Price contends that his people have good working conditions, interesting jobs, huge buying power and job security not offered by most hedge funds.

One thing he doesn't yet offer, however, is a share of the pie. Perhaps as a result, Price has lost more than a few protégés — some to hedge funds, where they *can* own a piece of the business. Last year foreign analyst Philippe Brugere-Trelat signed on with Leon Cooperman's Omega Capital Partners. Before that Don Parker and Merryl Buchanan left to set up their own hedge fund, Emerald Partners. Meanwhile, Bruce Crystal went to value manager Sound Shore Management, Michael Lowenstein joined New York–based Tyndall Partners, and Seth Klarman went to business school before joining Boston-based Baupost Group.

Succession aside, Price must also cope with growing the business while continuing to achieve those terrific returns. "He's torn," says one observer. "Part of him wants to take in a lot of money and collect an annuity, and the other part is an ego that wants to perform the best." So far Price has managed to do both, partly by closing the biggest funds for long periods.

Mutual Shares and Mutual Qualified were closed from 1989 through April of this year — not the first time that Price has pulled in his horns. As long ago as 1977, when Mutual Shares had only $30 million under management, Heine stopped taking new clients because he and Price were having trouble finding good values to buy. The funds' current 330,000-plus shareholders have paid back that loyalty with a word-of-mouth advertising campaign almost unmatched in the industry.

But Price may find the balancing act between growth and performance hard to continue; his net new sales are now $5 million per day, and large funds are simply less flexible. Price protests that he is challenged enough right now, but he clearly likes the idea of growing the business by adding new funds. Given the higher-than-average age of his shareholders, he says he is tempted "at some point in time" to grow by adding a fixed-income securities fund that would invest in Treasuries, junk bonds and real estate loans.

And performance? Stay tuned.