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Richard W. Perkins

Photographs: Mark Lohenberg for Barron's

Happy Hunting Grounds

This Money Manager Finds Winners Close To Home

RICHARD W. Perkins – via his Wayzata, Minn., firm, ***Perkins Capital Management****, runs some $100 million. Almost all of it is invested in companies that call the North Central states their home.*

In the 6½ years since Dick ended a long association with Piper Jaffray to set up Perkins Capital with his two sons, Richard and Dan, the three have seen the value of their equity accounts rise at a 21.25% compound annual rate, after fees and commissions. And they've seen the total of funds under their management-from individuals, pension plans, an endowment or two– grow from about $8 million.

Currently, Dick has the biggest slug of his portfolios in homegrown medical technology issues – some of which he likes even at their recent elevated levels – but the other stocks he's buying are a diverse lot, representative, he insists, of the corporate variety to be found in his chosen fishing grounds. He talks about them in the following Q&A.

–Kathryn M. Welling

BARRON'S: How did a nice fellow from the froze North ever get involved in Wall Street, Dick?

Perkins: I went to the University of Wisconsin and wound up taking a job with a bank in Chicago as an investment analyst in 1957. 1 became, shortly thereafter, a portfolio manager. But I really date my investment career from 1959, when I went to the Mayo Foundation in Rochester, Minn., for six or seven years and learned the business the way I still practice it today.

Q: Which is?

A: Very simply, trying to find opportunities by searching for change. Change is the key word. Back then, the Mayo Clinic did not solicit gifts. The money that was spent on medical research came from profits made on the endowment fund in the stock market. We literally ran a fund that was 100% equity and fully invested all the time. We were constantly sifting through it to see if we really liked new buy ideas better than anything that we owned. We really concentrated our shots. Thirty years ago, that was called "looking for special situations." What we were really doing was trying to identify something that was changing within a company, that we could capitalize on. And, at Mayo, there was a lot of investing in regional companies. Although subsequently I left the Mayo Foundation, I went to Minneapolis in 1966, and, with Mort Silverman, started an institutional research boutique for Piper Jaffray – where I stayed for the next almost 19 years.

Q: Until you formed Perkins Capital Management?

A: Yes, we started on Jan. 1, 1985. My two sons and I. We are out in a suburb of Minneapolis, a little town called Wayzata.

Q: Why the regional focus?

A: It is not just that I have lived and worked here for 30-plus years, and obviously know a lot about the companies here. But we concentrate on the upper Midwest, an area roughly analogous to the ninth Federal Reserve District, because there is a wide variety of very fine companies here. I believe very seriously that management is a very key part of any investment. It is important to know the management; to be able to visit with management; to know more than just one person in the companies. And, for a small organization, it is just not possible to do that if your investments are spread all over the U.S. Besides, we have such a terrific group of companies here to choose from – everything from the traditional old-line companies, Honeywell and Minnesota Mining & Manufacturing and General Mills, to numerous high-tech start-ups that have come out of the likes of Control Data and Medtronic.

Q: Clearly, with so many to choose from, you don't pick stocks solely on the basis of where they are headquartered?

A: Hardly. We apply the same criteria to these companies that we would to any investment. We get to know the management, follow them. Then we try to identify and invest in those that are undergoing some sort of change. It can be a new management, a new product or anything that we think gives the company an edge.

Q: And you stay pretty much fully invested?

A: I am usually fully invested. If you don't have your money in the game, you can't make any money. We don't try to time the market. We buy stocks, not the market.

Q: That means you've taken some pretty good bits, doesn't it, in recent years?

A: Occasionally, we will wind up with some cash. In the 1987 Crash, it just so happened that we had about 20% in cash. We had not predicted a severe decline in the market, but as that year passed, we sold some issues and we simply didn't have a lot of ideas for reinvesting the money. So, quite by accident, we had some cash.

Q: So the market does occasionally get too rich for your blood?

A: You do find at times that even stocks that you like a great deal have gone up beyond reasonable expectations. And, particularly if they are in accounts that don't have to pay taxes, then one may want to carve a little off. But, generally speaking, our portfolio strategy is not to sell a company that we like, while the party that we came for is still going on, just because it happens to have become a very large portion of a portfolio or of our overall assets. Often, things that you own are still the best ideas. Why should I sell a stock, pay taxes and then run the risk of having to find another one that is equal to that one? So, we let them run to wherever they take us.

Q: Yet stocks that take off for the stratosphere often turn out to be on parabolic trajectories.

A: Not without some warning. A good example is our No. 1 holding, SciMed Life Systems. It is now 10%, roughly, of the assets we have under management.

Q: Granted, SciMed has had a spectacular run. But don't you don't think it's gotten ahead of itself?.

A: Not at all. The stock is still relatively attractive, with good earnings momentum. Yes, it is much higher in price – has a higher P/E ratio – than it had as recently as a month ago. But it has finally gotten some of the recognition that it deserves. This company is increasing market share, not only at the expense of C.R. Bard but also of others, such as Pfizer.

Q: At the moment. But the competition isn't exactly sitting on their hands. And who's left to buy the stock?

A: All of those things are true, but we don't see the party ending at the moment and we've made about 20 times our money in SciMed.

Q: And you're not tempted to take some profits.

A: Actually, I have sold half of our SciMed position twice – and it still is our largest position. But having sold some along the way was absolutely wrong. Today, it is fairly priced. Its year ends in February. For this current year, it'll earn \$3.30. The following year, I expect \$4. So, it is selling at 20 times that 1992 estimate and 25 times the current year estimate. The company is growing 60% or 70% this year; looking out over the next several years, we can see 30% or more growth. Those multiples are reasonable for such a company. So we are hanging in there with SciMed, despite the detractors. When we do have a winner, we are not going to sell it just because it is selling at a high multiple. Or just because it has gone up. We are going to sell it when we see some fundamental change – a fundamental reason to do so.

Q: Okay. What do you like that hasn't taken off for the moon yet?

A: There's a relatively new local medical company that we own, Everest Medical, which has very modest revenues. It came public last fall, and has some of the things that we look for. No. 1, proven management. Everest's president had a career with St. Jude Medical then was president of a company in the angioplasty business that was sold to Pfizer. He is a proven guy.

Q: What does Everest do?

A: The company has developed electro-cautery devices that use the bipolar, rather than monopolar, principle. One that we think is going to be very significant for the company is an instrument used in laparoscopic – that is, minimally invasire surgery – which is growing by leaps and bounds for such things as gall bladder removal. With this surgical technique, several small incisions are made in the abdomen and little tubes called trocars are inserted, carrying a mini-TV camera and the surgical instruments. But the surgeons still have to stop the bleeding when everything is removed. One of the things they use is a staple gun – made, for example, by U.S. Surgical. Everest Medical makes a disposal pistol grip device that can cauterize the area rather than staple it. This, we think, has big potential. They also make endoscopic biopsy devices and so on.

Q: Has Everest Medical sold any of its cautery guns yet?

A: Oh, yes, but I'll admit that this is a little company with a relatively high market cap. There are probably five million shares outstanding. The stock sells for $5^1/_2$ or so. So you have a \$25 million-\$30 million market cap, while sales this year might wind up at a couple of million dollars, and it's still reporting losses.

Q: That's a pretty rich valuation isn't it, for a tiny company in a field that practically every medical supplier wants to enter?

A: True. But I think they can achieve, let's say, \$2.5 million-\$3 million in revenues this year. And next year, revenues could very well be significantly more than that. They have just hired a new sales manager from U.S. Surgical. Now, it's our job, since we live here and theoretically we know the people – this company happens to be located about two miles from our of- rice – to uncover the next, say, SciMed early on. Everest, with a very interesting product that is gaining acceptance among the docs and with a proven man at the top, stands a very good chance of being very successful. We want to own it now and if it goes down a little bit in price, fine. We'll buy some more.

Q: Where did you first buy it?

A: We bought a very little on the offering last December at around \$4 and we have bought more stock in the aftermarket at around \$6. We just add to the position as shares become available.

Q: The market is bumping around 3000 now. Are you expecting to have a chance to buy Everest – and a lot of issues – cheaper any time soon?

A: The market has been following the election-cycle script very well. Last fall, when everyone was chinning themselves on the curb, was when the election cycle said we were supposed to have a bottom. In the pre-election year, which is this year, we should be seeing some sort of an intermediate high in August-September. I expect that to come from slightly higher levels. Maybe 3150 or so on the Dow. If the market then continues to follow the script, we will have a correction that lasts into early next year, February or March. Then we should have another very strong move up into election time or possibly even into early 1993. And I see the market continuing to more or less follow that script.

The other thing that impresses us about the market is the rise of interest in small-cap stocks, which have been out of favor for years. From last fall, when we had this bottom, the place to be has been in small-cap stocks--and that cycle generally runs seven years. So that's where we are focusing.

Q: Okay. What are your four or five best ideas-...the ones that haven't been widely discovered yet?

A: One of my favorites is Fingerhut. This company came public last year at around $16\frac{1}{2}$ and the stock is now 28, so it is up in excess of 50%. But it is still a value here.

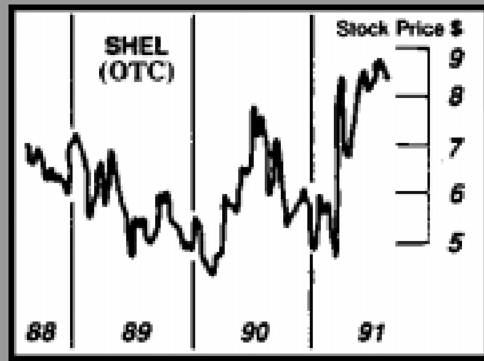
Q: How do you figure?

A: The company will earn $2.25 this year and $2.60 next year. So it is selling around 10 times next year's earnings. The reason that we continue to be excited about this company is, again, the management.

Q: What's to like?

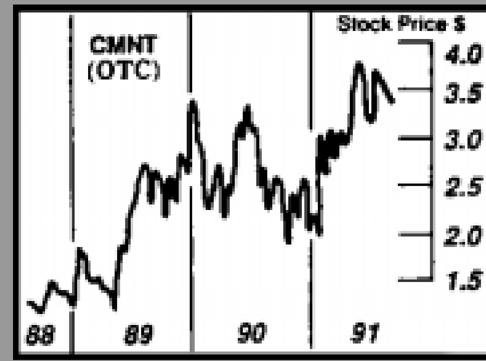
A: A fellow named Ted Deikel, who ran Fingerhut many years ago, when it first was a publicly traded company and whom I knew then. This man did an exceptional job building Fingerhut and then left to start another business, which he ultimately sold. Then he was rehired to run Fingerhut, which by then was owned by Primerica — Sandy Weill — but Primerica this spring reduced its stake to 54% from 71%. Anyway, here is a proven guy who really built the company, who has been given a chance to make it a success again. And, he has a terrific incentive to do so — he was able to purchase, as part of his deal, shares and options which amount to about 10% of the company. It is a unique situation. There really isn't another company anywhere like Fingerhut.

Sheldahl



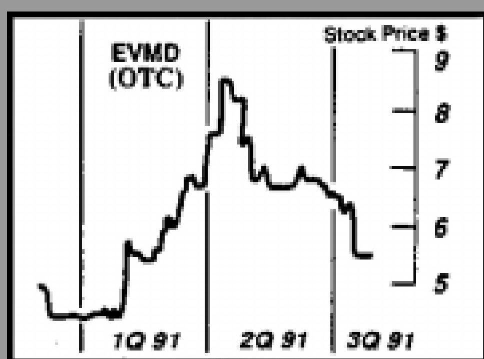
"We could see the stock double in the next year and a half."

Computer Network Tech.



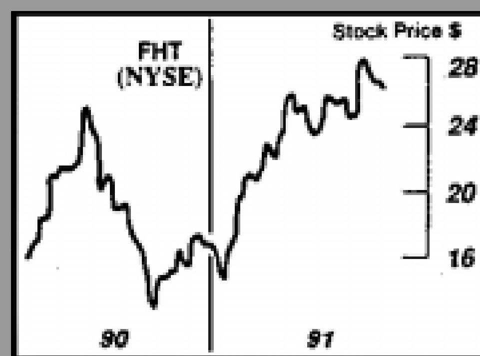
"It soon will have $25 million in revenues. It's time to own the stock."

Everest Medical



It has "a very interesting product that is gaining acceptance amoung the docs."

Fingerhut Companies



"Here's a proven guy who's been given a chance to make it a success again.."

Charts: *Barron's*/Telescan

Q: Wait a minute. There are a zillion catalog retailers out there!

A: That's right, but these people are not just a direct-mail marketer. If you 'could visit the company's headquarters, if you could see their computer capability, you'd realize they know more about every customer they have than any other company does. They are able to target markets very precisely. Fingerhut's market is primarily the blue-collar part of the workforce. Fingerhut provides credit. These people are not so much concerned about price, although Fingerhut's prices are good and their quality is good. They sell name-brand products. But their customers want to be able to buy by mail and to make monthly payments. I think the stock can sell higher, I really do.

Q: How about something whose attributes aren't as well-known?

A: How about a company called Sheidah?.

Q: The name doesn't ring a bell.

A: I have known it for 25 or 30 years, but never owned the stock until recently.

Q: Why?

A: We think a new management now is going to do the trick for it. The company had not done well over the years, primarily because of a business that it had in California, where it manufactured multi-layer circuit boards for the military. It just was never able to cope with that business. So the new management has bitten the bullet and closed the business, taking a significant write-off. Sheldahl is now going to concentrate on the business it knows best, which is located in Minnesota.

Q: Which is?

A: It is not a very large company, roughly $100 million in revenues. It makes flexible circuity for the automobile business, transportation, the insides of hand-held computers, you name it. Anywhere flexible circuitry is needed.

Q: Plain old wire is flexible, isn't it? Or are we missing something?

A: What Sheldahl makes looks like circuit boards but is flexible and can be bent around comers or made to fit into particular shapes.

Q: And this is the business you see restoring profitability to Sheldald?

A: Yes. Here is a stock that has been out of favor for a very long while. They are going to have to change their image, there is no question about it, but I have seen it happen before. The stock sells for around $9 and for the current year, which ends in August, Sheldahl will probably earn about 95 cents.

Q: Versus what last year?

A: It just about broke even, because of losses on the California operation. Actually, if you restate the numbers, take out those losses, Sheldahl's continuing operations earned about 85 cents last year. In 1992, we can see $1.15 a share or maybe a little bit more. We think that we are going to see gross margins expanding very nicely. And every 1% increase in gross margins can add 15-20 cents a share to earnings. So here is a changed company, selling for a very low P/E. There is not a great deal of risk and we could see the stock double in the next year and a half.

Q: Doesn't a Japanese company own a chunk of Sheldahl?

A: Sumitomo Bakelite Co. owns about 14%, but it is a long-standing relationship. They are not going to buy the company or anything like that.

Another stock that I find very interesting is in the networking business: Computer Network Technology. The symbol is CMNT. It trades around $3^1/_2$.

Q: Go on.

A: It's a very small company. One we have followed for many years. But it always seemed way out of reach in terms of price. Now we think that has changed.

Q: Why?

A: This company is growing at about 50% a year and it is finally going to get to the size — it's almost there — where it'll have enough revenues that the buyers of these systems will be able to buy from Computer Network and not be looked at as though they are taking a chance. You know, it used to be that when you were buying a computer, you would buy an IBM because you could never be criticized.

Q: In other words, Computer Network Technology has finally sold enough of its networks to be almost respectable?

A: It is soon going to have $25 million in revenues, and it is time to own the stock. So we took a position in it in all our equity accounts earlier this year, paying around $3 a share for a substantial number of shares.

Q: It's around $3^1/_2$ now, you said. Does it have any earnings?

A: Yes. It is on a calendar year and should earn 15 cents a share this year and at least 25 cents next year. It's growing at 50% a year.

Q: There are a lot of networking companies out there. Does this one do anything different?

A: There aren't a lot of companies in the area that these guys are in. They call themselves "the extended channel networking company." What that means is that they transmit data at very high speeds over very long distances. Distances that others are not able to do. That distinguishes them from all the other networking companies. The market that they are competing in is not a terribly large one. But they have a very substantial part of a niche market which is growing very rapidly. And, they are now beginning to market overseas. We understand there are some very large contracts with large domestic companies in the works. I just see real opportunity in this outfit.

Q: What else are you buying here?

A: We own shares in and have recently bought more in a company that is a turnaround from a near-disaster: BMC Industries, formerly known as Buckbee Mears. The name was changed to BMC a long while back.

Q: In the hope that everyone would forget.

A: Right. That was when Bob Carlson came in from United Technologies to turn this company around. The previous management had gone on a buying spree, which got BMC into all sorts of trouble. Bob Carlson and his people had to take it all apart, get back to its original businesses.

Q: Which are?

A: Making aperture masks for computer screens and so on, and making eyeglass lenses. The intriguing thing about BMC is that its earnings are going to be quite large over the next several years, but a substantial part of these earnings are being looked at by the investment community as being one-time earnings, because they come from selling equipment and technology to manufacture shadow masks to foreign countries, the most notable being China. This year about 70 cents of the $1.35 a share in earnings that we think BMC will report is coming from the sale of equipment and technology in China.

Q: what's so intriguing about that?

A: This contract is actually their second or third such contract. We believe that, in 1992, there will be another one that will add very significantly to earnings. We don't know how much, but we do know that such a deal is in the works. The contract that they just finished gave them, altogether, about 85 cents a share of profits, of which a little bit was recognized last year.

Q: Why should there be follow-on contracts?

A: Many of these large foreign countries with large populations need to have the knowledge and expertise to manufacture televisions for the populace. There are millions and millions of people and they simply don't have the communications. China is one. India, Malaysia simply need to have television sets. They are going to be making their own, but they have to buy the technology and the manufacturing equipment from companies like BMC. As time passes and these contracts keep coming, ultimately, the stock market will come to look at these not as one-time earnings, but rather as something that can continue. So, with the stock selling at $9 vs. earnings estimates for this year of, say, $1.35 and an estimate for next year of approximately the same, before anything that might come from further contracts, the stock has significant upside potential.

Q: But once the Chinese, say, have a couple of plants up and running, don't you think they'll figure out the technology for themselves?

A: They are not going to manufacture the manufacturing equipment. Believe me, this is very high-tech manufacturing. It does require technology and people who understand the technology. And there are many countries that need this.

Q: Want to mention anything else?

A: Lest you think that we don't ever invest in anything other than high tech, I'll mention Universal International.

Q: What is it---besides ambitious?

A: I have kidded the management, saying, "Well, why don't you make a complete job of it and call it Amalgamated Universal International?"

Q: What's their answer?

A: They laugh. Unfortunately, this stock has gone up and I really would hesitate to buy it at $15 a share.

Q: Then let's talk about something else.

A: The thing is, over the next several years, I see Universal International being a very big winner. I want to mention it because they are embarking on what might well be a very interesting new format for retail merchandising.

Q: What now?

A: Universal International is a wholesaler of closeout merchandise. There are many stores, as you know, that retail closeout merchandise. They go by many different names, but they all seem to have $1 in the name somewhere, implying that there is nothing in the store that costs over a dollar. They buy their merchandise from Universal International which has enormous amounts of warehouse space. It is able to acquire the entire closeout inventory of a company, and then wholesale it out to the retailers. And, as such, Universal International has had a very nice growth rate. In 1987, revenues were $10 million and then $18 million, then $26 million and $38 million last year. The company, stock symbol UNIV, came public at about $5 last fall.

Q: Why has it tripled since?

A: The reason is that, in addition to continuing their wholesale business, they are establishing, this year, four or five prototype stores to sell closeout merchandise at retail.

Q. Competing with their customers?

A: They are going about it in a little different way than any-one else. They are going to have higher price points, up to $10, and they are going to locate these stores in shopping malls or at least in strip centers. Most existing closeout stores are in low-rent locations. So Universal International is going to upgrade this business. This company has a very good shot at creating a very exciting new retail concept, and that's the reason for the premium in the stock right now. But there are also so few shares outstanding ...

Q: How many?

A: Less than four million shares. Anyway, we calculate that roughly something like each $1 million of revenues at retail in their stores could add a penny a share to earnings. We see the possibility of some very rapid growth beginning in 1992, but especially in 1993 and 1994. The wholesale business will continue to grow, and will produce good solid earnings this year, about 75 cents a share. Next year, the wholesale business could do maybe 90 cents a share and maybe a little bit more. And retail could add maybe 15-20 cents. Then, it would grow at a very significant pace.

Q: You're not concerned that Universal International's customers might object to it's competing with them at retail? Or that its suppliers might not cotton to seeing their closeout merchandise displayed in stores in the same kind of upscale locales that retail their pricey first-run stuff.

A: Those are the two questions that are always asked. And the answer is that, no, their customers really don't care because the customers want to buy from them anyway. Their customers are all over the U.S. and buy from others as well. They buy what is available. If Universal International makes a terrific buy on pots and pans, its customers aren't going to say: "Gee, we are not going to buy this item even though it is going to sell well just because you have a store in St. Paul." The same thing really is true as far as the second question is concerned. A lot of so-called closeout merchandise really isn't. Many companies are finding that if they can run an extra 100,000 of this or an extra 50,000 of that, they can bring their costs down on the entire run to such a level that they can sell the extra to a closeout outfit and still net more, overall. It is done quite regularly. We are interested because we smell something new here.

Q: Clearly, though, you're not alone.

A: Granted, the stock is up. We bought shares originally at $5 and we bought some more in the aftermarket at $4^1/_4$. Then we bought shares on the last public go-round at $10^1/_2$. Now, we find the stock is 15. So I would probably want to wait to see if I could buy the stock a little cheaper, 10% or 20% down, for instance, in a correction.

Q: Is that your last pick?

A: I could go on and on, but let me talk to you about National Computer Systems.

Q: Okay, talk.

A: It has been around for a very long time, run by a gentleman named Charles Oswald, whom I have had the good fortune to know for many years. In fact, he was the executive vice president of Jostens when it came public, in 1960. He has been with National Computer Systems for many years. And, the company has done very well over time. It was a gem of a stock in the early 1980s. But for the last four or five years, it has lost its way. They made the mistake of getting into areas they really didn't know anything about. The CAD/CAM business, for example. As a result, the stock has not done anything, literally, over the last four or five years. Been stuck in a range between 15 and 7. Earnings have been pretty fiat, too. In 1986, they earned about 90 cents a share. Then earnings went down a little. In 1988, they earned about 90 cents. In 1989, they earned about 90 cents. It's on a January year.

Q: So, what's to like?

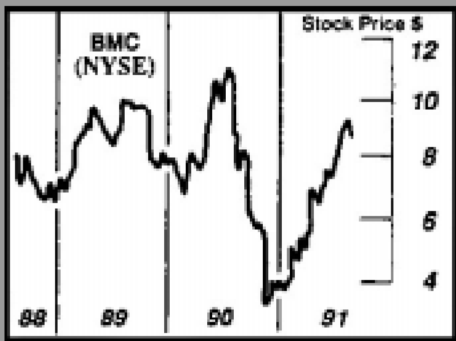
A: About 1½ or two years ago, they decided to restructure, to get back to the businesses that they know about. That's exactly what they have done. They have been selling things off, taking write offs, straightening out the balance sheet. Now, all of a sudden, we are finally going to see earnings up from that roughly 90-cent area. We are looking for $1 a share in this current year, and next year, $1.20. And, we see continued growth after that because they have a very exciting new product.

Q: Don't keep us in suspense.

A: They make scanners and scanner systems, software and forms, primarily for the education market and then, secondarily, for industry. They have a new scanner, called the Precept Image System, which is very expensive- $500,000 a copy.

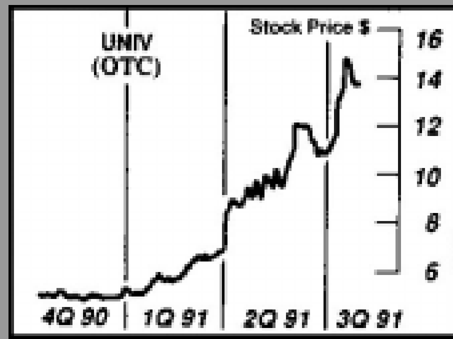
Q: They will sell a lot of those

BMC Industries



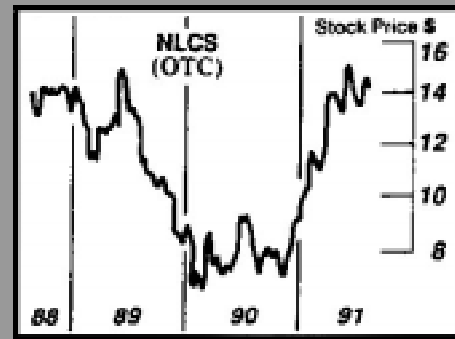
“As contracts keep coming the market will look at these not as one-time earnings.”

Universal International



“I’d wait to see if I could buy the stock a little cheaper in a correction.”

National Computer Systems



“We are finally going to see earnings climb out of the 90-cent range.”

into the education market!

A: Well, this scanner will read printing, even my hand printing, as bad as it is. It does optical-character recognition. It also will read bar codes or any kind of optical marks. But what sets it apart is that it will read hand printing. For example, it was beta tested with Avon Products. The Avon rep uses a preprinted form, but there are certain things she or he has to add — the customer's name and address, for instance. This scanner will read not only the optical marks — so many jars of face cream — but it will also read the hand-printing, at very high speeds. We understand that the beta test was very successful and that there are going to be follow-on orders from Avon. It is also being beta tested in the health-care area with U.S. HealthCare. We understand that — get this now — the scanner can be cost-justified in one year, despite its $500,000 price tag.. We think that they can sell quite a few of them. Wouldn't it be nice if this stock could be recognized enough so that it could bump itself up above this $15 barrier that has been holding it back now for five years? I think that is likely.

Q: Is there anything in your neck of the woods you don't like?

A: We are not a hedge fund, so we don't sell short — and if we were, we'd have a difficult time finding things here in our area to short. Occasionally, though, we do see companies that we think are ahead of where they should be in terms of price vs. earnings. That is the case today with Medtronic. We like Modtronic. It is a great company. But with the stock around $125, and with its earnings for the year ending next April probably coming in around $5-$5.25 a share, that's about 25 times earnings for a company that has a basic growth rate somewhere in the 15%-18% area. So, we would not be interested in that stock unless it came down pretty significantly.

Q: Thanks, Dick. ■