

Early Growth Investor

Unlike growth investors who specialize in only certain industries in search of growth, Kalmar Investments applies a consciously more wide-ranging approach to identify companies with sustainable earnings growth. Ford B. Draper Jr., portfolio manager of the Kalmar “Growth-with-Value” Small Cap Fund, and his 9-person research team primarily use the firm’s internal resources to identify growth businesses at an early stage with a clear multi-year timeframe in their assessment.

What is your investment philosophy?

We call our philosophy and approach “Growth-with-Value” because we focus on owning high quality, vigorously growing smaller companies that we can also buy inefficiently valued. This lets us tie ourselves to the compounding enterprise value of productive businesses while also enjoying complementary valuation expansion in their stocks as other investors come to appreciate the business merits that our original research has uncovered. What we are seeking is “All Weather” performance, namely to outperform in fruitful markets while also protecting better in down markets. It is a genuine wealth building strategy that has a longer term company ownership investment intent and lower turnover than most growth managers and is grounded on intense, in house, original research.

What makes small cap stocks so volatile and what causes volatility, in general?

Smaller-cap stocks are thinly traded

“We diversify intentionally by company growth character within the portfolio while we remain committed to owning growth companies with real revenues, real earnings, and real cash flow that we can also buy inefficiently valued, always seeking higher reward with lower risk results.”

and, importantly, represent more focused company business models along with other similar considerations. Because of that, they react more sharply to changes in the market, and to changes in specific industry fundamentals as well as to changes in the big picture outlook. Our objective is to invest in this volatile asset class with a higher reward to lower risk outcome and with generally lower volatility and strong risk-adjusted returns.

Would you describe your investment research process?

Kalmar Investments was founded around an original research commitment. Our firm includes 24 employees; nine of whom are full-time research people, including myself. All nine are generalists, but generalists with overlapping areas of vertical domain expertise. The team has real seasoning, with an average of 21 years experience as creative research analysts and stock pickers in the smaller and mid-cap market segments.

We believe our research adds value in three ways. First, through the independent discovery of top-notch companies that can grow better than most other investors expect. Second, through the deep business evaluative aspect of our research that confirms the drivers behind such businesses and provides the conviction in their growth prospects necessary to buy them. And third, through conventional securities evaluation,



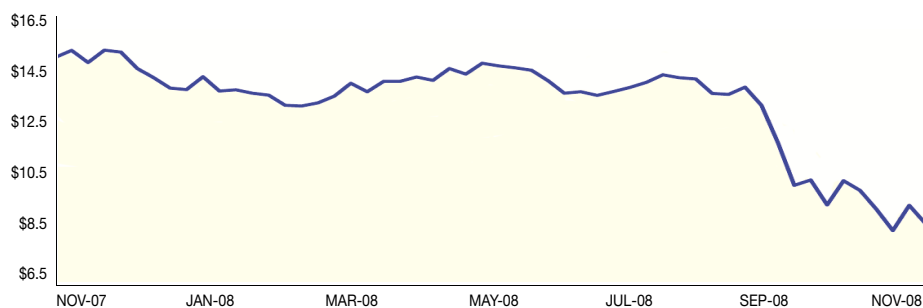
FORD B. DRAPER, JR. founded Kalmar Investments in 1982.

Draper began his career in the investment research and capital management departments of Smith, Barney & Co., in New York before joining Baker, Fentress & Company, a \$350 million publicly-owned closed-end mutual fund, performing original investment research on a broad spectrum of companies and industries, in 1970. For the next 12 years at Baker, Fentress & Company Draper had responsibilities as Vice President that included trading, investment research, investment strategy, and management of the Fund’s portfolio.

Draper is a graduate of Yale University and received his MBA degree in Finance from Columbia University Graduate School of Business.

Performance - Price History N.A.V.

Kalmar "Growth-with-Value" Small Cap Fund (KGSCX)



	2005	2006	2007
Russell 2000 Growth Index	4.15%	13.35%	7.05%
Kalmar Growth-with-Value Small Cap Fund	5.26%	6.17%	12.68%

namely, the specialized risk/reward judgements, value-seeking disciplines, portfolio decisioning, and trading skills that are more demanding in the volatile small cap world.

As a growth investor, are you interested in understanding, or at least having some sense of, where the future may lie?

Naturally. That is where the second element of our research value-added comes in -- the business evaluative part. While no one can predict the future perfectly in a tough, competitive, changing world, we make intelligent projections of company future growth based on understanding their particular fundamental drivers, the catalysts to positive change, the capability of management, and their competitive advantages. This involves deep face-to-face discussion with management, analysis of capital efficiency, plus customer, competitor, supplier analysis, etc. Our objectives are to determine how innovative and competitive a company's products and culture are, all leading to conclusions about the success and profitability of its future growth.

Using those inputs, we create our own independent earnings, cash flow, and balance sheet estimates looking out a year through three years. We are looking for

factors that can contribute to significantly higher earning power potential than is discounted in the present stock price and the strategies management has to execute to make that happen. In effect, we are trying to benefit from a proprietary perceptual research edge in each business we own. That allows us to both own businesses that grow their enterprise value powerfully, as well as having their inefficient initial stock market valuations (think of P/E ratios) rise as a complement. In this way one can generate the higher reward with lower risk portfolio outcomes Kalmar seeks.

Are there particular industries you focus on?

No, however, there are industries that we typically avoid: highly cyclical ones or bad ones such as airlines, and we normally have a low weighting in financial services companies. Based on the high rates of growth we expect our companies to generate, our prejudice is that most financial services companies cannot grow at those rates without taking undue credit granting risks or undue underwriting risks. We seek the better business model in all cases, along with a company that has truly sustainable competitive advantages.

Otherwise, our willingness to search

widely and creatively bottom-up across the economy rather than staying focused on more traditional "growthy" industries certainly differentiates us in what we do. Furthermore, we seek to own a range of companies by different growth character because we think it gives us the opportunity to buy exciting businesses that are often more inefficiently valued, rather than focusing solely on the sort of GARP company that "Growth-with-Value" might suggest, that is, if you didn't know better.

There is another benefit as well to this. Owning a conscious mix of growth characters ranging, say, from Steady Eddie growth, to innovative emerging growth, to also include positive transformation growth allows the portfolio to stay that much more relevant through all phases of a total market cycle. This contributes to our objective of achieving "All Weather" returns.

What kind of conditions do you identify as likely drivers of sustainable revenues or growth?

We like to own particular companies positioned in growing markets with real runway room ahead of them. This relates to products and services of conspicuous value to such growing markets. Such a company will have capital efficiency advantages, which enables them to create cash flows that, in turn, translate into better internal investing in R&D, etc., further raising their competitive advantages. Ideally, they also have particular management cultures that can sustain these advantages.

We never invest in businesses with a timeframe of less than about a year. We hope to find ones that can thrive in a multi-year context, and have managements capable of creating great options for future growth well out into the future.

Could you highlight some examples of sustainable growth investments that have met your criteria over the years?

At present we own GameStop, the leading computer gaming retailer. It

represents an amalgam of GameStop and Electronics Boutique. We owned GameStop prior to its acquisition of Electronics Boutique. It is a high growth retailer in a special less-economically sensitive niche as well as having a major market share in used game retailing. The company dominates the resale of used games, which have a notably higher margin than newly released products and which encourage more frequent store visits.

GameStop generates high returns on capital and sustainably high square footage gains as it grows out its store base geographically. It is also highly cash flow productive and capable of investing in its business while repurchasing shares at the same time. Having owned the stock for almost six years, we think of it as a “reliable earnings powerhouse”, within the context of the several business growth models we seek to own in our portfolios.

Another example would be Corrections Corp. of America, which is in the prison construction and management business and serves the overflow needs of states and branches of the Federal government. This business grows relative to the crime rate, which grows faster than the population. It has a higher growth rate than the overall economy and one that is inversely correlated to the economy, which helps portfolio diversification. Being the highest cash flow generator and the most accomplished manager of this demanding business has allowed them to grow at a faster rate than their competitors.


A retail company like GameStop, generally, overexpands or its business growth may start slowing down. How do you tackle future uncertainty on these fronts?

There are several ways in which we address maturation. The first way is based on deep initial research that attempts to determine realistically how much more growth such a business may have. We are typically involved in businesses before they get so large that they slow down or need to go through a di-worsification, hubris-

related acquisition, or whatever. Secondly, as we carry out our hands-on research, we attempt to remain skeptical and identify businesses risk as well as opportunity. Thirdly, we use strong valuation sensitivity to try to protect ourselves going in, in the event our early conclusions were to be wrong. Fourth, we have a sell discipline to try to protect the portfolio if we are unlucky enough to be there when risks start to reveal themselves. For instance, because we have deep overlapping industry knowledge on the research team, we parachute another knowledgeable analyst into stocks with sharply declining relative strength to attempt to catch problems in progress before they become serious.

Finally, there is one other consistent practice we follow that helps guard against things going wrong, be it slowing growth or other risks. We call this our “peel the onion” strategy. Grant that we’ve bought a vigorous grower at an inefficient valuation. The company’s rapidly growing profitability over time prompts a revaluation upward in P/E to complement earnings growth, so we get a handsome profit. Now we have a fairly valued stock but whose underlying business continues to be able to grow strongly. At that point, we “peel the onion”, that is reduce the holding by one-third to one-half, for redeployment into yet another undervalued good grower.

This accomplishes several things: hedges against unforeseen business risk, say, slowing growth, or market psychology risk; keeps the overall valuation of the portfolio reasonable and its mix of holdings refreshed; yet allows a fine growth business to continue to compound its value in the portfolio, which also contributes to a preponderance of long term gains in the portfolio.

Of course, if we conclude the company doesn’t have the potential to create great options for future growth, then we sell the whole thing. We are good at this “peel the onion” safeguarding strategy and it works well in an always uncertain world. 

Kalmar “Growth-with-Value” Small Cap Fund

Symbol	KGSCX
Website	www.kalmarinvestments.com
Address	Kalmar Investment Advisers 3701 Kennett Pike Wilmington, DE 19807
Telephone	800-282-2319
Inception	04/11/1997

PORTFOLIO (AS OF 11/30/08)

Total Net Assets*	\$221
Avg Mkt Cap (\$ Weighted) *	\$1,300
Average Price/Earnings Ratio	14.50x
Average Price/Book Ratio	1.59x
Turnover Ratio	34%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$10,000
Min Subsequent Investment	\$1,000
Min Initial IRA Investment	N/A

RISK (AGAINST RUSSELL 2000 GROWTH INDEX)

Alpha	-0.21
Beta	0.94
R-Squared	0.96
Ann Std Deviation	19.38
Sharpe Ratio	-0.65

RETURNS VS. RUSSELL 2000 GROWTH INDEX

	KGSCX	Index
1 Year (Cum.)	-40.41%	-41.34%
3 Year (Ann.)	-11.08%	-10.94%
5 Year (Ann.)	-3.56%	-3.29%

RETURNS VS. RUSSEL 2000 INDEX

	KGSCX	Index
1 Year (Cum.)	-40.41%	-37.46%
3 Year (Ann.)	-11.08%	-10.13%
5 Year (Ann.)	-3.56%	-1.65%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	2.00%
Total Expense Ratio	1.34%

PORTFOLIO MANAGER

Ford B. Draper Jr.	04/11/1997
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*millions **3 months after purchase

Data through: 11/30/2008; Source: Company Documents; Lipper

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