We had the pleasure of speaking with Kevin Durkin, Chief Investment Officer of Ballina Capital, about his path in investing, his investment process, how he generates ideas, how he thinks about portfolio concentration and manages risk, as well as some of the books he has found most influential.

This conversation is available as an episode of Invest Intelligently, a member podcast of MOI Global. (Learn [how to access]() member podcasts.)

The following transcript has been edited for space and clarity.

John Mihaljevic: It is a great pleasure to welcome to this conversation Kevin Durkin, founder and chief investment officer of Manhattan Beach, California-based Ballina Capital. Great to have you here, Kevin.

Kevin Durkin: Thanks very much for the opportunity, John.

Mihaljevic: Maybe we could start with your background as an investor and the genesis of the firm.

Durkin: Like many portfolio managers, I've always been analytical by nature. After college, I found my way to Wall Street and received some credit training at a major bank. I moved along to performing research on high-yield and distressed companies. For me, that was a real introduction to the markets. I got to work around some very smart people and came to a much stronger understanding of capital structure, valuation, and scenarios.

However, I wanted to improve my skill set, so I went to business school. I got my MBA from the University of Chicago. After school, I ended up joining a buy-side equity firm. This group was here in Los Angeles, where I still live. It turned out to be focused on international companies. Though I had already invested a bit overseas, this really opened my eyes to the world beyond American shores and the complexity of investing successfully overseas.

It was a steep learning curve, but I climbed it. We eventually started a new firm, Causeway Capital. This was in 2001. I ended up having a very significant impact on the portfolio after we started Causeway, responsible for stocks that were 20% to 30% of the portfolio over my tenure there. I received great financial rewards for this work at my former firm, but I eventually decided that I wanted to leave and start my own firm. In 2017, Ballina Capital was born.

Mihaljevic: Causeway is a pretty well-known firm in the value-oriented space, right?

Durkin: Absolutely. While I was there, we grew from nothing to $40 billion of AUM by the time I left. It was a great experience in an employee-owned firm and one that put clients' needs first. For those less familiar with Causeway, it's very much known for its international equity capability with a value style for US institutions. It was a great experience investing overseas. We had extensive access to C-suite-level executives. It wasn't unusual for us to own 5% to 10% of companies.

I often get asked the question, "Why would you leave that?" The answer is always difficult. I have great friends there. It's a wonderful firm with very smart people, but what I could see was that I wasn't having as much input into who we hired or retained. I was a bit worried about culture. Also, it was important for me to have an investment process that we stuck to, and there were some divergences within the investment team.

Finally, we had simply grown to be very big. I thought it was increasingly difficult to source investable ideas in a firm that was and is that large. Yes, it was a great experience for me and provided me with the experience to start this firm and be in the place where I am today.

Mihaljevic: You started Ballina Capital in 2017. I'd love to hear a bit about the goals and the guiding principles behind the firm.

Durkin: We want to be first and foremost known for integrity and transparency. I want to be brutally honest with folks. With our clients, it should be nothing less than that. They should very much understand how we do things and how we invest. If we have made mistakes, we should admit those and be very clear about it. If they need information or any kind of data, that should be forthcoming with ease. We operate with humility. That's extremely important to me. If we're managing money the way we have laid it out, mistakes should be very few, in my view.

Those are the important tenets I think about – integrity and transparency. Beyond that, we would love to have the firm be as much employee-owned as possible. I've seen that be successful in my past. We would like for our firm to be known for having a passion for stocks. We research fundamentals on companies and select stocks from the bottom up. Let's enjoy that. Let's enjoy that today. Let's enjoy that ten years from now. People can see that.

Alignment is important. Today, I have much of my personal wealth invested in Ballina strategies. As we grow, it should remain that way – the portfolio managers having significant investment alongside our clients.

As far as culture, I want to build a team-oriented firm, one where people can work collegially. It's important for folks to be known for substance, not for polish. I don't want a culture known for being political. All of these things are difficult to achieve, but that's what we're aiming to do here.

Mihaljevic: In terms of your investment process, could you walk us through how you go from looking at the entire investable universe to getting to the portfolio?

Durkin: We have two investment strategies, but they have essentially identical investment processes.

For international all-cap value, the equity universe is comprised of roughly 5,000 stocks spanning 47 developed and emerging international markets. The eligible companies have a market capitalization of at least $500 million. Now, if we're looking at the global small-cap value, that would include the US, and then the cap on market cap would be $5 billion. There are a few more companies in that universe, but it's essentially the same process for each.

There are three steps to the process. We identify, then confirm, and finally construct. As far as identification at the start, we have one screen that is refreshed on demand. Generally – at least in the case of international all-cap value – 600 stocks would pass that screen at any given time, and a stock needs to pass all of the parameters to pass that screen.

These parameters include valuation (as you would expect), quality, and also asset intensity. That last part is unique. The reason we have it there is that we screen for and today invest in some of the cheapest companies. Some would describe us as a deep-value investor. What I have noticed is that if companies with more tangible assets come into difficult times, if investors can see that there are tangible assets – it could be property and equipment, factories, or cash and securities – they are less likely to punish that stock severely. They can see that the company can crystallize those assets. Ideally, the asset intensity component of the parameters is helping us avoid value traps. We're going to have to work hard to avoid those stocks anyway, but we want something on the front end that gives us some assistance.

We have these 600 companies that come through the screen. We won't be able to do work on all of them. In the confirmation step, we want to first evaluate – on a very high level – risks about the company. Are there other concentrations we're uncomfortable with? Are there cash flow issues we should be concerned about? Are there things that make it so that we don't want to go further?

If we do, at this point, we will do a deep dive on the company. It would involve reading as much as we can about the company and its industry and spending a lot of time on the financial statements. We will prepare a proprietary quantitative valuation on a two-year time horizon. Often, we find can add value at that point because many of the companies we're looking at are smaller or international or both, and they're off the radar screen. We don't screen for this, but oftentimes, they are companies covered by maybe two to three analysts on the sell side, so there's not much understanding there, and people can miss the detail or the nuance. When we go in and do that valuation, in some of our best investments, we can find that the current price of the stock doesn't make much sense to us.

Once those price targets are validated, the stock's going to a rank sheet, which organizes the stocks from high to low based on expected return. We use that rank sheet as a roadmap to build the most competitive, diversified, and liquid portfolio possible. We build portfolios of roughly 35 to 45 stocks. We select stocks, not markets. We don't have country or sector limits. It's a bottom-up, research-intensive approach to selecting stocks.

One important thing I would also add is that we have a sell discipline. When we monitor the portfolio every day – as we would have to – if there is a stock that is having a very difficult time, we are willing to admit that maybe our timing is wrong.

We don't profess to be perfect on timing. Let's trim or exit that position, and we can focus on the 30 to 40 other stocks we continue to like. Let's not allow it to get emotional. Let's not allow it to bog us down. We don't have to spend that much time on this. In some cases, in our experience in the four-plus years doing this, we've come back to companies. We've trimmed or exited them and then come back and invested, and those worked extremely well. It's an interesting and important part of the way we do things.

Mihaljevic: Let’s talk about the international or global aspect a little more. How do you and your team scour the globe for ideas?

Durkin: It is important for us that our ideas only come from our screens. Some might ask, “Why be a slave to the investment screen?” There are reasons for it. For one thing, we want this process to be repeatable. Sticking in a diligently disciplined way to the screens can help make this process repeatable, one where five to seven years from now, folks can see that we’re doing things exactly the same way.

Also, I believe keeping that discipline to the screens as far as idea generation is important to the team and culture. You want people not to think of the ideas as “it is this person’s idea,” and when things go wrong, ascribe blame. The idea should be that this is our process; if anything, blame the process or blame the screens for why we’ve maybe ended up with a poor stock. Ideally, we should have an attitude where, if we have had something go wrong, we can all collectively learn from that.

Mihaljevic: That’s a great point. I feel like a lot of folks don’t want to stick to using screens or maybe don’t even want to admit they’re using screens a lot because it does sound a bit mechanical. I guess it sounds a lot better to say, “We have this network of investors. We get ideas in many different ways.” However, the truth is that, as you say, when you have a process that does use quantitative screens, it seems more repeatable and more disciplined because it’s
not so ad hoc.

Can you tell us more about the screens? What are some of the main criteria in there? What kinds of stocks do you exclude from the screens, perhaps in terms of geography, market caps, or other factors?

Durkin: To make the screen, you have to have at least a $500 million market cap. As I mentioned, some of the parameters of the screen are valuation focused. While it’s proprietary, it’s nothing revolutionary. There are also quality parameters. Again, those aren’t that revolutionary, but we have a parameter that incorporates asset intensity, and that is different.

There will be stocks with a big presence in other value-style funds that won’t screen for us, and they’re more likely to be companies where they’re much more highly intangible. I think it comes from my experience of investing. A lot of what colors me or informs me as an investor today comes from the mistakes I’ve made over the years. I don’t think you learn as much from the successful stocks you have, but you remember every mistake, right?

When there were companies that didn’t have as much of the tangible assets backing them and you fell a bit maybe into the group think of “these are good companies, this is their cash flows, they are trading on 7X or 8X cash flow, and this is a reasonably priced company,” I found that when these types of companies disappointed, it was at a time when the expectations were just too high, and conditions changed for them, and they came up short. I found that such companies got punished extremely severely by the market.

What these initial screens do is help us stay closer to companies that we can buy at a low price, and that downside should be very limited.

In our experience of doing it over four years, we've tended to find that we invest more often in groups of companies that I refer to as the underclass. By this I mean that they are off the radar screen of larger investors. We believe that's the best hunting ground for value stocks. At Ballina we experience two types of off the radar , or in my words, underclass stocks. In the first type, these companies have never gotten onto the radar screen of larger investors. It's possibly because they're small, complex, not very well covered, or just not extraordinarily exciting. Maybe they're family-owned or family-controlled. In the second type of off the radar companies that we experience, they've just disappointed too much. You can think about these as companies that have underperformed for five and six years. The analysts – buy side or sell side – that recommended them six years ago are done with them. Maybe the analysts have been reassigned, but they're clearly not backers anymore, and they're probably not closely following these stocks. Behavioral biases cause these factors.

If we're doing this right, the screening should help us identify companies where, with patience and work, they can eventually get onto the radar screen of larger investors. But we tend to invest before this has happened, when they are still in this kind of underclass situation. They are off the radar screen when we are doing our work. It's anecdotal, but oftentimes, when we reach out to talk to companies, they will say to us, "Why are you interested in talking to us? No one else is."

All of this starts with the screen, the discipline of sticking with the screens, and then there's an awful lot of work to getting to valuing and selecting the companies. Then we monitor those price targets all the time. We're keeping an eye on constructing the most diversified portfolio possible. The sell discipline is important as well because if one company is hugely disappointing, we don't have to distract ourselves with a situation where the file on it just gets larger and larger trying to figure out how we were not so wrong in our assessment. Again, we're not professing to be perfect on timing.

Mihaljevic: I'd love to understand the asset intensity aspect a little better. Are you saying you want companies with a lot of tangible assets backing, whether that's real estate, other PP&E, or what-have-you tangible balance sheet type of assets?

Durkin: Yes, exactly. Oftentimes, we find – and this is more prevalent in Asia – you'll come across companies with cash or securities, investment holdings that can amount to anywhere between 30% to 90% of the market cap. Even before you've gotten to valuing the business or the cash flows that can come out of it, you're pretty close to getting it for free. Those are situations you can and will come across overseas.

Yes, we're looking for tangible assets. We believe those are going to help protect us on the downside. We are going to have companies that are out of favor or have been going through a difficult time. We like companies that we believe have the potential to improve their margins and returns if we can get those situations, but sometimes that takes longer, or other issues hit them.

The idea should be that if we have invested in a stock having more difficult times, the market isn't pushing that stock down to an even more depressed level because they're thinking that in a company much more based on intangibles, it's the people or maybe the client relationships that are making the business. We're less interested in companies where the loss of a massive client or teams of people effectively leads to a lot of the value walking out the door.

Mihaljevic: Makes sense. The downside protection aspect is very clear when you have a lot of NAV and are buying below that. How do you guard against the value trap aspect? In my own experience, it is often the companies that look cheap on an NAV basis, where maybe due to not-so-great corporate governance or not much interest in unlocking shareholder value, they can languish for a long time. How do you guard against that?

Durkin: It's a part of what we do every day because we invest in the cheapest companies. We have the protection at the front end with this asset intensity component. Then, we have protection in our sell discipline. The idea isn't that we're having a bad quarter, and therefore we should be selling six or seven stocks at a time; it's that sometimes we do get involved in a company where it does look maybe not exactly like a falling knife but there's a stock chart that looks top left to bottom right. When we get involved in such companies, we're just sensitive to the fact that their challenges, their issues, and their perception by the market may be tougher than we realized. We can believe there's value there, and we can decide that the timing could be better. Both of those things can be true. We allow ourselves to exit or trim that position and move on.

I can only tell you about the way it has worked for the last four-plus years. It's been an extremely tumultuous time for a global investor. In our first year or so, there were a number of our UK positions that were affected by Brexit. Then later there were trade wars, and then COVID came. Now, we've had Russia and Ukraine. From what the process has produced, I can tell you that there have been very few cases where companies have disappointed us. Sometimes, people have looked at the amount of exposure we've had to Financials. We own less today, but we've owned more at previous times. Folks have said, "So many of these have been such value traps. How can you put so much of the portfolio in these financials?"

What we see from experience is that the screens and the process have helped us avoid the worst of the group. I can tell you we haven't had any German banks come through the screen. Deutsche Bank and Commerzank, which are very cheap on book value, weren't companies coming through our screens. If we look at UK banks, we did have Barclays and Lloyds come through the screen. We did some work on them, but we chose to invest in smaller UK banks. In our perception, in our work, the smaller UK banks that we identified had a much better ability to accrete capital, to generate returns and, most importantly, pay us dividends because we like to see that for the risk of investing in financials. We like to be able to rely on those dividends. Those smaller, more off-the-radar companies ended up performing significantly better than if we had gone with Lloyds or Barclays.

Another example I can give you is the German property company that's in the news today. Adler came through our screens. We did a bit of work on it but couldn't make sense of the financials. The leverage looked very high to us, and the cash generation didn't look like it was there. That was never a stock considered for the portfolio at all.

We have invested in other property companies. There are some property companies that come through our screens today. In only a few exceptional cases have we been disappointed, and yet we've been able to put together strategies that have quite a deep value style to them. When value has been in favor, we've tended to do very well. When value is out of favor, we tend to hold our own.

Mihaljevic: Interesting that you mentioned Adler Group. It's a German real estate company that I believe has had a pretty prominent short thesis out there, but I guess it does screen well on stated NAV. However, as you say, there's a ton of leverage. Does that mean you tend to avoid highly levered companies?

Durkin: Yes. I was credit trained at the beginning of my career, and I guess I couldn't leave that completely behind. I very much approach equities as "we're the last in line." There are so many claims in front of us, so we want to invest in companies where the balance sheet is robust. That's been my experience throughout my career.

In international markets, it's easier to find more robust balance sheets. I believe international companies tend to be more conservative about how they set up their finances. We saw a bit of that going into COVID because revenues dried up overnight. In some cases, it was the US companies in our small cap that were more of a challenge because US company managements are much more likely to push things to the edge as far as where their leverage should be. The international companies we owned were not under stress because their balance sheets were built for the so called rainy day.

Mihaljevic: What do you look for in terms of management or corporate governance? I ask because it seems like a lot of companies that have very rich balance sheets in terms of cash or other tangible assets and that trade at a big discount to that often have governance issues.

Durkin: To be honest, I think a lot more about the quality of the business. As far as management goes, clearly, you want management that are honest and doing what they say they would. Oftentimes, when we do our work, we end up liking the management, but I wouldn't say it's the be-all and end-all for us. The view I've come around to is there can be managements that haven't been as inclined towards shareholders. You need to work on that and figure it out. If they've got a goal or agenda opposed to yours, you shouldn't be involved.

That hasn't been our experience, though. I think part of it is that valuation is an important motivator. If a company is trading at a depressed valuation, it eventually motivates the board and management. It takes longer in some cases. It can take longer as an international. In the US, those kinds of motivations crystallize much more quickly. You probably have an activist moving. You'd have the board remove the management. Internationally, it takes longer, but I think, in a way, that's worked out in our favor because many of these companies have disappointed. In some cases, the companies we've invested in disappoint for a very long time. They've gone off the radar screen, which allows us the opportunity to get involved. When we get involved, we often deal with new management.

In the best cases, what I've been finding recently is that you have a CEO who was a leader of another company in the sector. They've had experience making big decisions. They've probably gotten some things wrong at their previous location. Now, in their second or third home, they've learned from some of those mistakes and can realize what they need to organize a bit differently and do better.

The other example we get often internationally is family-controlled companies where a member of the family is running things. In our experience, they're running things quite conservatively, which is fine. Just understand that it is the way things are going to be run. We're getting involved in situations where we're buying at low prices. It'd be much more challenging to get involved in a company like that where you're paying higher prices and there's an expectation that the story would evolve very positively for equity shareholders. We can be patient and understand the way they're choosing to manage the company and be comfortable with that as long as it's not a situation where they're diametrically opposed to their equity shareholders.

Mihaljevic: How do you think about portfolio concentration? How much do you like to have in your top 10 holdings?

Durkin: Our two strategies have 35 to 45 stocks. As you would imagine, when things were much more distressed – say, around the spring of 2020 – we concentrated the portfolio more. It was 35 stocks or maybe even a bit smaller than that. When the markets look a bit fuller, we run closer to 45 stocks.

Ideally, what we'd like to do is not try to be too precise about the sizes of the positions in the portfolio. Get a stock in, then ideally let its success – or lack of success – take it to a new weight. We tend not to let positions get above 5% of the portfolio. In terms of the top 10 positions, I think today it's 33% or something like that, but sometimes, it's more like 40%. Again, there's no hard rule about that. It's just where the market has taken some of our stocks, between 3% and 5%. We're pretty sanguine about their exact size.

We consider the volatility of the portfolio in an overall sense. We want to be diversified. We're wading among the cheapest companies globally. If there are certain sectors or geographies that we're already quite present in that are really very cheap at that time, we have to be aware of that. For example, when we started Ballina, US retail was coming through the screen very heavily. This brought volatility in those stocks. When we felt like we had enough, what you choose to do when looking at the screens for a new company is avoiding – in this example – US retail.

Mihaljevic: In terms of risk management, you talked about it on a security-specific level as well as in terms of portfolio concentration. What are some other aspects of how you manage risk?

Durkin: We look at the volatility of the portfolio, the volatility of the individual names. I view risk as the volatility of returns. If we look at our four-plus years doing this, we have had volatility that's more than that of our benchmark. What we can say is we aim to limit our volatility. We're not promising to keep it below that of the benchmark.

I think the level of volatility we've had can be explained by the fact that we are present in smaller companies – certainly relative to the benchmark – and we're heavily leaning towards value, and we have a pretty concentrated strategy. I think that explains the volatility. It's also been a tumultuous time, so we've had periods where the markets had pretty serious downdrafts over the last four years.

That's the way we think about it. We're trying to be as diversified as possible. We're paying attention to the volatility of those stocks and how that can be informing us. When and if the volatility of those stocks changes and/or new correlations crop up, that's new information.

There's the example of an Italian financial we've owned over the years. In 2017 and 2018, it was a depressed stock, partially because Italian political risk was considered quite high and the spreads of Italian government bonds versus Germany were quite wide. As that political risk was seen to lessen, the volatility of the stock declined, and it turned out the company delivered, so the value improved quite significantly. More recently, with Russia invading Ukraine, investors once again were considering sovereign risks. The spreads of Italian government bonds again started to go out against Germany, and the volatility of that Italian financial went up again.

You always have to be paying attention to volatility and risk in the portfolio.

Mihaljevic: A lot of value investors like to say they view risk as permanent loss of capital, not volatility. Help us understand how your view differs on that and why you are looking to limit volatility.

Durkin: I have sympathy with that view. It's not that I disagree with them.

When we're thinking about individual companies or how we're constructing a portfolio, that is definitely the mindset, but it comes more from the standpoint that our strategy will get taken up by allocators who will use us as perhaps their international equity allocation or their global small-cap allocation. They want to be able to compare us against the larger universe, to be able to compare us against that benchmark. From their standpoint, they might be looking at that volatility as a judgment of how much risk we have taken and then judging whether they're being compensated for that risk. We are sensitive to it because we believe it's an important data point to an allocator bringing funds to us.

Mihaljevic: Certainly. I think many investors have gotten burned by not focusing on volatility, then they realize they have a business to run, and a lot of clients do actually run when market quotations go down, even if that's unjustified in the short term. I think you touched on an important aspect of managing an investment business, which is that you have to be aware of who your clients are and make sure they have a product they are aligned with, mentally as well, because a lot of folks say they can take volatility ahead of time, but when it arrives, it turns out that many people cannot really take a lot of volatility.

Kevin, one question we like to ask is about books and reading recommendations. I'm wondering if there are any books you have found particularly influential and would like to share.

Durkin: As far as investing, there's not all that much for me. Warren Buffett's *Investment Letters* were obviously influential. In terms of finance, what is most helpful and stays with me are the negative stories. I think the book *Extraordinary Popular Delusions and The Madness of Crowds* is important because it reminds us that bubbles have gone on for as long as commerce has existed on earth. It's just human nature.

I enjoyed David Einhorn's book. I always enjoy seeing or hearing what a short seller like Jim Chanos says. I have a lot of respect for anyone who spends much or all their time on the short side. I truly enjoy Jim Grant's newsletter and continue to do so.

I read everything. I like to read things that are mostly not in finance. Some other things I've read recently that I greatly enjoyed were *It's Even Worse Than It Looks* by Mann and Ornstein and *The Age of Turbulence* by Alan Greenspan. For me, those kinds of books put into context how much the world has changed, and it's very complex and challenging.

I think investing is very personal. Your reputation and clients' money are at stake. Early in my career, I could see that my boss badly wanted a TMT stock. I wanted to do this for him. I was looking to fulfill this need. I did a lot of work, came up with a TMT stock, presented it, and we invested. It did very poorly because the TMT bubble had collapsed. It was dependent on the capex from the whole ecosystem, which went down. The valuation was never ridiculous, but the revenues of the business fell. What I learned from that day is that you have to stay with your gut and please yourself. I value a sense of independence. My approach and framework very much stay independent.

Mihaljevic: Finally, how can fellow members learn more about you and your firm?

Durkin: We write newsletters although not every month. They can get on our mailing list through our website. We send out some monthlies to the allocators we're aware of.

We're looking to get our name out there more and more. We have a website and there's some information there, including our performance.

About:

Kevin Durkin, Chief Investment Officer of Ballina Capital, was a founding member of Causeway Capital. He served as a Portfolio Manager of Causeway Capital Management from 2001-2015. Kevin has a long history of successful stock selection.