Friess Introductory Webinar Transcript
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Speaker Details:

S1 – Tracy Rogers, *Moderator*
S2 – Gordon Kaiser, *Managing Partner for Friess Associates*
S3 – Scott Gates, *Portfolio Manager for Friess Associates*

Transcription:

S1 00:03 Hello and welcome to the Friess Associates introductory Webinar. After todays slide presentation we will take some time to review topical question that has come up in recent conversations with our prospects and clients. I would now like to turn the conference call over to Mr. Gordon Kaiser, Managing Partner and Mr. Scott Gates, Portfolio Manager at Friess Associates. Gordon and Scott, please go ahead.

S2 00:25 Hello. This is Gordon Kaiser, and my role at Friess Associates is Client Service; I am joined today by Chief Investment Officer, Scott Gates. We are set to introduce our organization, philosophy and process. We'll also provide an update on positioning and performance. So, let's jump right to the presentation on page three. Friess Associates was founded in 1974. Original portfolios were all cap, and over time we offered cap specific management based upon client demand. The small cap composite started in 1981. In 2001, Affiliated Managers Group, AMG, bought controlling interest in Friess Associates. However, coming out of the 2008, 2009 recession, the original AMG agreement did not make sense for either party, so Friess bought AMG's interest in 2013. We believe clients benefit from our employee ownership. All resources go back into the firm. Employee ownership further aligns our interest of clients, and holding equity in Friess Associates is a great tool to retain and attract talent. On June 1 of this year, we converted the Friess Small Cap Trust to the Friess Small Cap Growth Mutual Fund. The performance record of the trust ported to the mutual fund.

S3 02:05 Our investment team and traders are listed on page five. We have an experienced and motivated team, with each holding equity in Friess Associates. Turning to page six, a distinguishing attribute of Friess is our non-traditionally structured research team. Our researchers are generalists, which helps us avoid biases and gain an appreciation of different P/Es across sectors. We utilize an all cap research process to improve information flow. It yields better idea generation and risk control. Researchers typically hold approximately 15 stocks, which allow them to know companies very well, be highly convicted, and allows for the pursuit of new ideas. Let's turn to page eight so that Scott can introduce our investment philosophy.

S3 03:04 Thanks, Gordon. Well, as Gordon said, we believe earnings and all those inputs to earnings drive stock prices, and we do this by conducting deep fundamental analysis to get an information edge. So what are we looking for? Companies that top expectations, companies with the most potential to positively surprise, and it is a best ideas portfolio. We build our portfolios from the ground up on a stock-by-stock basis based on their upside. So just to reiterate, we are investing in stocks specific secular businesses with significant earnings upside. So how do we do this? Let's go to page nine. This is our pool of candidates. And simply, what we're looking for is a minimum 20% or higher earnings growth, a reasonable PE that we can attach to that earnings growth. And we'll look at peer and comp multiples, historic multiples, and relative to market multiples. We're also looking for experienced management that has a history of executing strong balance sheets and earnings catalyst that's likely to exceed consensus earnings estimates. What I mean by earnings catalyst, this can be something as simple as the earnings conference call where the company may beat the estimates and raise possibly a new product, a new market. Even a change in the competitive landscape can be a catalyst. We're really looking for something that will ignite the Street's interest in the name.

S3 04:42 So moving to slide 10. This is really our differentiation, deep intensive research. You could've pulled this slide out 25 years ago from our deck; it would've been very similar. As Gordon said, it's an all cap approach. In other words, we're looking at large cap and mid cap we're looking and talking to large cap and mid cap companies who may be customers of many of our small cap companies that we're also looking at. So around our target market, we're looking and talking to customers, competitors, suppliers. We do about a 100 of these a week. A lot of private company conversations, as well as consultants. And what we're really trying to do here is build a mosaic of data points together to help us make decisions on every name we own. There's real time research sharing. For example, we might have an analyst down in Nashville talking to HCA or Lifepoint hospitals, another at the same time in Washington, DC, talking to the trade group, and possibly one in New York City that's at a healthcare conference. After their meeting or having these conversations with these people, they're dictating the body of that conversation in a digital research transcription system. All of this information is disseminated to everybody in research so there's really good research sharing, a lot of cross pollination, and certainly emphasis on teamwork. This is all in an effort to leverage our resources, contacts, and expertise. Incidentally, in this organic process is where we find most of the new ideas that we pursue as possible candidates to go on the portfolio.

S3 06:37 If we split to page 12, layering on top of this research process is risk control. This is where we spend a lot of time and capital building risk control measures into our systems. I have real time granularity on our stock and portfolio risk, specifically sector weights and cross sector exposures. So as Gordon said, we build our portfolios on a company-by-company basis. Approximately 50 to 70 names in the portfolio, 10 to 15 names per analysts, one stock, one analyst, so there's the direct accountability. And I as CIO have veto power over any name before it's bought. So specific risk controls, position sizes on initiation are 2 to 3 percent. Maximum industry weights 15%, for example, semiconductors. And sector maximum weights are 35%. This really pertains to the larger sectors in our benchmark, that being tech, consumer discretionary, healthcare, and industrials. So all this leads to high active share, high information ratio, hence, low benchmark correlation. So we are positioning to beat benchmarks, not mimic them.

S3 08:07 Moving to slide 13. So just as essential it is that we have conviction on our names and our buys, we must have discipline on selling names. So there's four reasons why we sell a name. Number one, price target is achieved. We reach our price targets on earnings upside and we attach a very conservative multiple of that to get to our price target. So from our process standpoint, if a price target is reached, there's no upside left in that name, that may generate a sell signal. Secondly, Wall Street becomes overly optimistic. They may get ahead of the fundamentals of the story as there is a risk that the company will miss a quarter or miss guidance, and that too may generate a sell decision. Thirdly, fundamentals deteriorate. As we continue to do maintenance on names, we're constantly looking for upsides to those estimates. We do come across negative data points that change the thesis of why we would own this name. That too could generate a sell decision. And then finally, forced displacement. So replacing good ideas with great ones. Every day, every name is ranked in our portfolio with its upside to price target. When we find new ideas, new dynamic ideas that offer 45, 50 percent upside, it ensures that we sell that name that has 2 to 3 percent upside and replace it with that one more dynamic idea that has 45% upside. So our sale disciple leads to really strongest ideas in the portfolio and an optimized time value of client's money.

S3 10:04 So turning to slide 16. Where are we positioned now? Current positioning in tech really themes of telecom equipment build out, specifically optical, as well as iPhone, semis. Healthcare device manufacturers, and health care services. Really outcomes based and population health drivers, not biotech. Industrial's stocks not dependent upon fiscal stimulus, but really stories of outsourcing. So let me hand it back to Gordon for some numbers.

S2 10:45 Thanks, Scott. Turning to page 17, we show our results over a variety of time periods. We are working on our fifth consecutive year of benchmark beating returns, and we expect our strategy to get traction and generate strong returns when earnings matter. On page 18 is our five-year up and down market capture chart. This is the type of up and down market capture our process should generate. We expect to participate and add value in up markets. In down-markets, we expect to add significant value based upon our process and research structure. Our PE discipline directs us to invest in stocks of modest PEs. These tend to perform better than high PE stocks in difficult markets. Our generalist research structure makes it easier for our researchers to move to more attractive opportunities with changes in the economy. Scott, can you touch up on page 21?

S3 11:51 21 really is our proof page here. And if we execute right, then this should significantly give us a case for buying growing rapid companies **at** reasonable prices. As you see in the earnings growth, that dark blue bar really is the Street's estimates for our companies. In most cases, we are significantly higher than those estimates. So it's understated there. This also brings the P/E lower on the bottom bar chart to below both our benchmarks on the growth side as well as the Russell 2000. We expect to see stronger earnings while trading at near or lower PE multiples than what the Street indicates.

S2 12:41 Thank you, Scott. This concludes our prepared remarks. But we have conducted a number of meetings with clients and prospects in recent weeks, and we'd like to share some of the questions that we've been asked. Scott, your small cap strategy sounds as if it's actively managed. Can you talk a bit about turnover?

S3 13:02 Sure. Well, we talked about building our portfolios from a company-by-company basis, from the ground up, stock by stock. So it really is a portfolio of best ideas and those stocks with the most upside. Each name competes for its position within that portfolio. And our sell discipline, the forced displacement, and this is primarily reaching price targets over the last three years, optimizes this process and client's time value of money.

S2 13:36 Scott, in the current post-election environment, policy changes in Washington are slowing. How has this impacted your stocks?

S3 13:45 Well, our focus is really on the fundamentals of our very dynamic companies. These are very secular stock specific stories that should do well regardless of what happens in DC. We simply don't own names based on a macro view, be it the price of crude oil, the yield curve, possibly policy in DC. All these could represent additional upside to our stocks from an earnings as well as a sentiment perspective, but they are not the core thesis of why we own any name.

S2 14:21 Finally, there has been substantial outperformance of growth stocks versus value. How do you view the underlying stocks from a valuation perspective?

S3 14:32 Well, we continue to find very interesting, compelling stocks with powerful catalysts that are selling at very conservative multiples relative to the upside we see. We are not for a lack of ideas. It's still a very inefficient market if we do the work. And although we have high active share in our portfolios, many of our names are in both growth and value indices. For example, AdvanSix, Mercury Systems, Emcor Group, Oclaro, Helen of Troy, great stocks from our perspective, regardless of the indices that they are included in.

S2 15:12 Terrific. This concludes our remarks. Thank you for joining us. We think this is an opportune time to learn more about Friess Associates and our small cap growth strategy. Our all cap process is proven effective in isolating attractive ideas and identifying risk in small cap investing. We have an experienced, motivated team, and we designed our organization for client success. Please contact us with any questions.

S3 15:42 Thank you.

S1 15:44 Thank you very much, Scott and Gordon for taking the time today. The webinar has now concluded, and thank you for listening.