Looking Forward

Friess Associates market observations and insights

December 31, 2021

Earnings Optimism Persists as a New Year Gets Underway

Surely record proliferation in special purpose acquisition companies, or SPACs, reveals a speculative streak that should remind investors of previous periods marked by excessive risk-taking that ended in ugly fashion. Likewise, chat-room-coordinated efforts by retail investors to put the squeeze on hedge funds by opposing their short positions en masse must signal that the market is coming unmoored.

A new Covid variant threatens to revoke some of the social and economic freedoms vaccines helped us win back. Inflation flirts with 40-year highs, leaving the Federal Reserve Bank poised to raise interest rates for the first time since 2018. Share-price valuations hover well above historical averages.

An incomplete list, it nonetheless packs a sufficient level of uncertainty to provide cause for concern. Still, despite those potentially problematic issues, major indexes marched on to their third consecutive year of double-digit returns in 2021. The S&P 500 Index tallied 70 record-high closes during the year.

Causes for concern, no doubt. They change in form and scale as time passes, but they are ever-present. While they warrant investor attention, we believe such matters should only evolve into influences on stock prices to the degree that they impact individual-company fundamentals. We are glad to see the broader investment community appeared to share that thinking in 2021, and we believe there is reason that market mindset could persist in 2022.

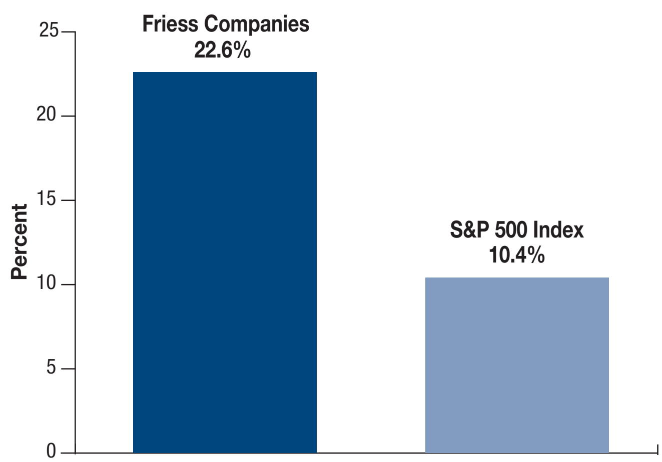
Among all the reasons to fret last year, profit growth was not one. Analysts predict the collective fourth-quarter results for the companies in the S&P 500 Index will show 19 percent year-over-year earnings growth when the final tally is in. If that's the case, calendar-year earnings growth will top 45 percent versus the pandemic-depressed year before, according to FactSet Research Systems.

There's always a chance companies will fail to deliver what the investment community expects in the fourth quarter, but that's been a bad bet throughout the pandemic. S&P 500 Index companies exceeded the consensus estimate by 10 percent or more for the past six consecutive quarters.

What's more, the companies in the index appear poised to finish 2021 at record levels of profitability. Data compiled by FactSet puts the S&P 500 Index's net profit margin for the year at 12.6 percent. That shows that companies were adept at overcoming some of the more pressing challenges they faced, most notably higher inflation, labor shortages and choked supply chains.

Analysts expect the trend to continue. Current estimates forecast a new profit-margin high mark in 2022, at 12.8 percent. With that in mind, the consensus among analysts is that the companies in the index are headed for another year of double-digit earnings growth in 2022.

Estimated Earnings Growth



Forecasted Increase in Earnings Per Share 2022 vs 2021

Source: Consensus estimates from FactSet Research Systems Inc., as of December 31, 2021.

This is not a forecast of future performance. Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio.

Pricing power is a significant reason why some companies can protect their profitability even as costs rise for things like labor, transportation and raw materials. In the current climate, we're prioritizing companies that can raise the prices they charge customers for their wares without depressing demand.

From the perceived value conferred by a trusted brand name to supplying a component that's critical to a business customer's end product, companies draw pricing power in a variety of ways. For more detail on pricing power, please see page 3.

Companies held in the portfolios we manage are expected to grow earnings 22.6 percent on average in 2022, according to consensus estimates compiled by FactSet. The companies that make up the S&P 500 Index are expected to grow earnings 10.4 percent on average in the same period.

When it comes to businesses hit with rising costs due to pandemic-induced constraints, the new car business is a veritable poster child. The average new car in America sold for 13 percent more in 2021 than the year before as semiconductor supply chain bottlenecks severely restricted automakers from delivering new car inventory to dealerships. Incentives and haggling are, for now, are out of style. Prices are prompting would-be buyers to delay purchases.

Meanwhile, demand remains strong among customers of Driven Brands (page 4). Sluggish new car sales benefit the company since its businesses focus on fixing, maintaining and washing the cars that are already on the road. Plus, Driven Brands enjoys customer loyalty thanks to respected, well-known brands, including Meineke, Maaco and Take 5 Oil Change.

Still, the reason we like Driven Brands goes beyond our confidence in its ability to prosper in current conditions. Founded as Meineke Discount Mufflers 50 years ago, Driven Brands became the nation's largest automotive aftermarket service company through organic growth and acquisition. The company holds an estimated 5 percent market share, leaving abundant room for continued growth, especially in the fragmented car wash market that it entered in the summer of 2020.

As if digital transformation wasn't reshaping business and broader society at a breakneck pace already, the pandemic introduced an even higher gear. The speed at and degree to which business and entertainment moved online raised unprecedented challenges in terms of capability and capacity. Globant (page 4) provides software engineering services to companies, including Disney and Google, that help them manage their digital footprints.

Globant's strength is its staff, comprised of more than 21,800 information technology professionals working out of 18 countries. Demand trends currently put Globant in a position to be selective in the clients and projects it takes on. Reflecting this, clients representing more than $1 million in annual revenue increased 37 percent in the 12 months through September versus the prior year.

The strained supply chain continues to fuel strong demand and favorable pricing for freight transportation services. That's good news for Hub Group (page 5). The company's intermodal solutions business, consisting of a coast-to-coast network of 4,000 truck drivers in 29 terminals, is a critical link in the supply chain, able to take cargo straight from ports to railroads and final destinations.

In addition, Hub Group offers dedicated trucking, truck brokerage and logistics services. The company's main advantage is its operating efficiency. Hub Group grew earnings 73 percent on 16 percent revenue growth in the September quarter. Also, the company in October acquired Choptank, which specializes in temperature-controlled logistics solutions, diversifying and enhance its service offerings.

SGH (page 5) is a changed company. That's a simplification of the message the company sought to send in October when it changed its name from Smart Global Holdings to establish a new identity as a holding company focused on "operational excellence and sustainable growth." Recent results support the sentiment, with the company growing earnings 163 in its fiscal fourth quarter, topping the consensus estimate by more than one-third.

In practical terms, SGH is diversifying its revenue stream to be less dominated by computer memory sales, which accounted for 53 percent of fiscal fourth quarter revenue, down from 77 percent in the year-ago period. The difference is being made up by more profitable products and services, ranging from data-center infrastructure and LED lighting components to solutions that leverage artificial intelligence and data analytics for applications in supply chain management, health screening, military systems and others.

We're encouraged by our ability to identify individual-company earnings strength amid current conditions. Thanks for your long-term focus and continued confidence.

Scott

Scott Gates
Chief Investment Officer

Preserving Profits Amid Rising Costs

In December, the Bureau of Labor Statistics reported that the inflation rate in the U.S. rose 6.8 percent in 2021, marking the highest yearly increase since 1982. The reasons behind the outsized increase include a global pandemic and related supply chain and labor-market disruptions. Year-over-year comparisons were also impacted by government shutdowns and depressed spending. What high prices mean for the year ahead is less clear, which is why we think individual-company fundamentals will be the best guide.

Energy was the biggest contributor to the annual increase in inflation. Apparel, new and used car sales, and home prices also increased. Amid a continued debate on whether current inflation levels are transitory, we start the year considering it a material risk to income statements. Pricing power, or the ability to raise prices to offset inflation and other factors, will be a crucial competitive advantage in the year ahead.

Rising costs can erode a company's profit margins. Companies with sustainable pricing power can protect margins by passing costs along to customers.

Trying to buy a car in current-day conditions involves a lesson in supply and demand. Near the end of 2021, the average new car in America sold for $46,036, representing an increase of $5,266 over 2020. Manufacturers slowed or paused production last year as they struggled to procure specific components. The average new car contains more than 100 tiny microprocessors, controlling everything from engine timing to smartphone connections. With these microchips in short supply, prices for cars able to reach dealers soared.

While yet to be seen, these increased prices are likely to recede as shortages moderate. There are some signs, however, that auto production may never return to pre-pandemic levels. Ford, for example, said publicly that it plans to move toward a build-to-order model in which dealers keep fewer cars in stock and most buyers custom-order the vehicle they want.

Chipmakers are making progress on catching up on production, but still face considerable demand from an increasingly broad array of new applications and customers. Pricing power begins at the foundry level, with higher costs passed along in an industry where consolidation leaves fewer companies creating specialized chips. With 50 percent-plus gross profit margin profiles for many companies in this space, the ability to pass along price increases creates favorable fundamentals.

Prices for staples like milk, coffee and shampoo are also on the rise. The multinational conglomerates that produce them also face higher costs caused by pandemic-related supply chain disruptions and input inflation. Where in the chain these price increases occur, whether at the manufacturer, distributor or storefront, will likely impact performance.

Procter & Gamble was among many consumer goods companies that said it would offset higher costs for commodities, transportation and freight with price increases. Management also added that they will be monitoring consumption trends as the pricing reaches store shelves.

We think companies with strong pricing power…are best positioned to navigate the market environment ahead in 2022.

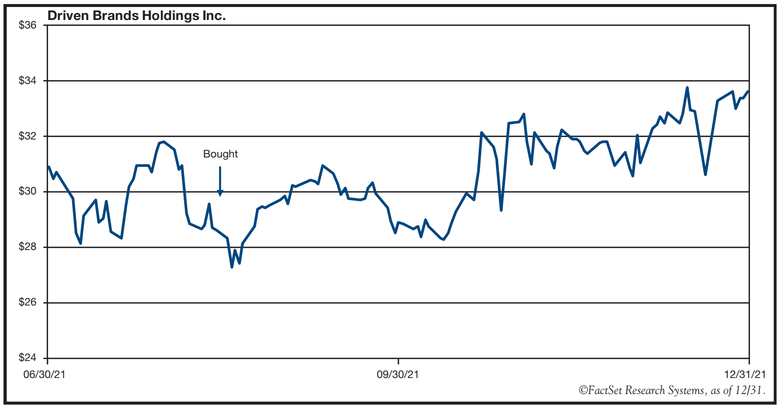
"Farm to table" takes on a whole new meaning in the current environment as the costs of growing and distributing food skyrockets. Global fertilizer prices reached record highs last year, in part due to rising prices for the natural gas used to produce them and severe storms in the United States that disrupted production. At the same time, virtually all other input costs, ranging from farm machinery to seed, are on the upswing as well.

With farm incomes in decent shape following strong 2021 yields, fertilizer companies stand to again benefit from demand this spring. That said, higher costs still create hard decisions for farmers given volatile weather patterns and other situations beyond their control. As it becomes more expensive for producers to grow corn, for example, they may begin to contemplate changing their crop rotation to a less nitrogen-rich commodity like soybeans.

While many elevated costs should retreat as the pandemic fades, some are likely to persist. Higher wages meant to attract and retain employees are not likely to be reduced any time soon, meaning companies will need to offset labor costs through increased volumes or higher prices to preserve margins.

Almost every company we evaluate in the current environment faces increased costs to some degree. We think the companies with strong pricing power, giving them the ability to preserve profit margins without depressing demand, are best positioned to navigate the market environment ahead in 2022.

Driven Brands Holdings Inc., DRVN



In 2003, Meineke Discount Muffler Shops became Meineke Car Care Centers, conveying that the company's business was bigger than mufflers alone. The company became Driven Brands a few years later and embarked on a years-long series of acquisitions to expand its footprint and scale. Today, consisting of a family of businesses focused on fixing, maintaining and washing cars, Driven Brands is the largest company of its kind.

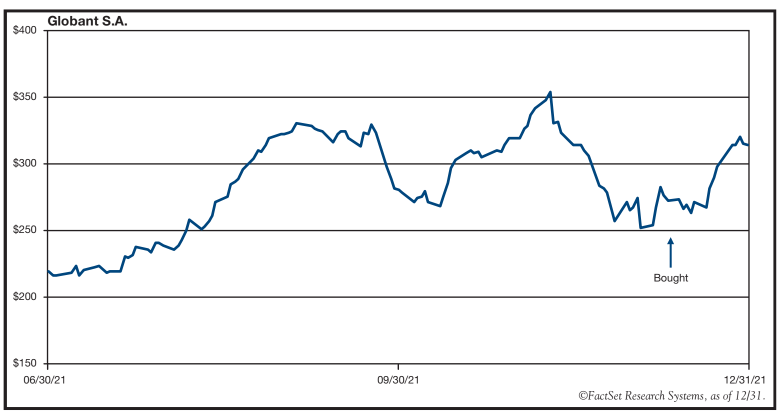
Nasdaq-listed Driven Brands Holdings Inc. operates automotive aftermarket service companies through more than 4,300 locations in North America and 14 international markets. The company provides a range of services, including paint and collision, glass, vehicle repair, oil change, maintenance and car wash. Its brands include Meineke, Take 5 Oil Change, Maaco, 1-800-Radiator & A/C and Car Wash USA Express. Revenue reached nearly $1.4 billion in the 12 months through September.

Driven Brands grew September-quarter earnings 30 percent, exceeding the consensus estimate on strength in the company's maintenance and car wash segments. Same-store sales grew 13 percent, with all four of the company's divisions posting growth. Driven Brands also raised its full-year guidance.

While it stands out for its size, the company estimates its market share at less than 5 percent, leaving ample room for growth in the auto care market. The car wash business, which Driven Brands entered through its August 2020 acquisition of International Car Wash Group, represents an especially promising opportunity due to its fragmented nature. Driven Brands also offers car wash subscriptions to generate recurring revenue.

Based on the consensus estimate, Wall Street predicts the company to finish 2021 with 104 percent earnings growth.

Globant S.A., GLOB



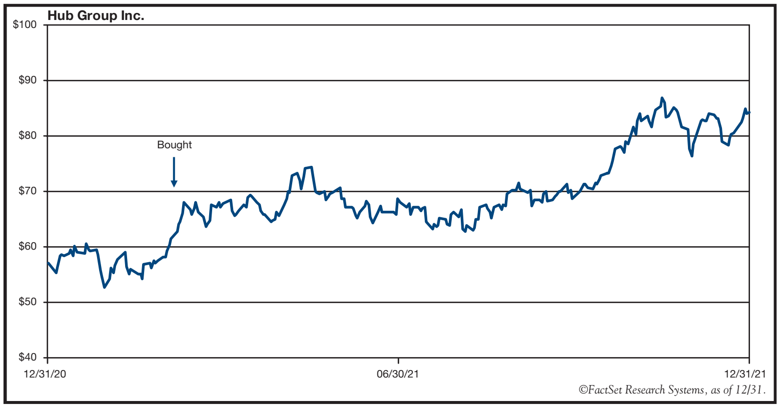
As online consumption and the need for work-from-anywhere capabilities surged with the global pandemic, most organizations were forced to evaluate their digital footprint. According to the International Data Corp., digital transformation spending is expected to reach $6.3 trillion between 2022 and 2024. Globant provides the leading-edge engineering and design skills that enable businesses to reinvent and stay relevant in this environment.

NYSE-listed Globant S.A. is a technology services provider focused on delivering innovative software solutions by leveraging emerging technologies. The company combines the engineering and technical rigor of information technology services providers with the creative approach and culture of digital agencies. Globant employs more than 21,800 professionals across 18 countries. Sales grew 50 percent to $1.1 billion in the 12 months through September.

September-quarter revenue and earnings both grew more than 60 percent, beating consensus estimates. Demand and spending from customers, including Disney, Google and Electronic Arts, remained higher than pre-pandemic levels. To support the elevated demand, significant headcount additions are ongoing, which bodes well for future growth. Your team met virtually with Chief Financial Officer Juan Urthiague and discussed how the strong demand environment allows the company to be more selective with its client base when taking on new projects. During the 12 months through September, Globant served 1,018 customers and continued to increase revenue per client, with 162 accounts generating more than $1 million in annual revenue versus 118 in the year-ago period.

Based on the consensus estimate, Wall Street expects Globant to finish 2021 with 51 percent earnings growth.

Hub Group Inc., HUBG



Global supply chain disruptions increasingly strained the transportation industry over the past 12 months. Even with volumes squeezed by driver shortages and congestion at ports and railroads, Hub Group's focus on improved productivity enabled the company to deliver in terms of its bottom line.

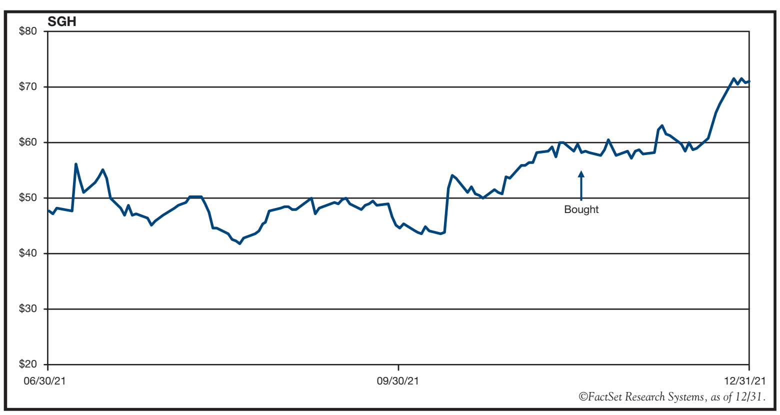
Nasdaq-listed Hub Group Inc. is among the nation's largest providers of intermodal transportation, which involves moving large-sized goods in the same steel containers through two of more modes of transport. The company also offers dedicated, truck brokerage and logistics services. Hub Group utilizes an asset-light strategy, employing a combination of company-operated and third party-owned equipment, to optimize investments and limit capital outlays. Sales grew 14 percent to $3.9 billion in the 12 months through September.

Strong freight demand and favorable pricing conditions drove 16 percent revenue growth in the September quarter. Earnings grew 73 percent, exceeding the consensus estimate.

Your team spoke to Hub Group management about the company's ongoing focus on yield improvement and operating efficiency. Record profitability and strong free cash flow fuel Hub Group's ability to reinvest in the business. In October, the company announced it would acquire Choptank Transport for roughly $130 million in cash. Adding Choptank, which specializes in temperature-controlled logistics solutions, is expected to create numerous cross-selling opportunities across a larger customer base.

Consensus estimates forecast Hub Group finishing 2021 with 66 percent earnings growth, followed by 26 percent growth in 2022.

SGH, SGH



Smart Global Holdings went public in 1995 and was acquired by a private equity firm in 2011 before re-entering the stock market in 2017. In October, the company changed its name to SGH to let investors know that it continues to transform.

Until recently, Nasdaq-listed SGH primarily made computer memory products. While memory still generates most of its revenue, SGH in recent years expanded its focus through acquisitions as part of a strategy to diversify and improve its growth prospects. The company now consists of three business units: Intelligent Platform Solutions, Memory Solutions and LED Solutions. Customers include Dell, Hewlett Packard, Samsung and the Department of Defense.

Revenue increased 34 percent to $1.5 billion in the 12 months through August.

Memory generated 53 percent of revenue in the company's fiscal fourth quarter, down from 77 percent in the year-ago period. The new focus enabled SGH to offer more custom products and court more customers in specialty markets, contributing to profitability. SGH earned $2.16 per share in the quarter, up from $0.82 and 35 percent higher than the consensus estimate. The company's gross profit margin rose 690 basis points to more than 26 percent.

In addition to memory, SGH's portfolio now includes products and services ranging from data-center infrastructure and LED lighting components to solutions that leverage artificial intelligence and data analytics for applications in supply chain management, health screening, military systems and others.

Based on the consensus estimate, Wall Street expects SGH to grow earnings 23 percent in its fiscal year ending August 2022.

Prioritizing Earnings Expertise Above All Else

Friess Associates doesn't employ a technology analyst. No one here spends all his or her time researching health care companies, either. Same goes for retail, banking, industrial equipment and so on.

The fact is we don't want a narrowly focused expert making buy recommendations from a single sector because we don't believe it's possible to identify the best available investments when the analyst making the call only considers certain possibilities. We rely on earnings expertise to drive our decision making.

We believe earnings drive stock prices. As a result, our research effort is a far-reaching search for robust earnings growth under very few constraints. To us, individual-company earnings power is the deciding factor in determining which investment opportunities hold more potential than others.

That's why Friess researchers are generalists. With a team average 25 years in the investment business, everyone boasts specialized knowledge in one area or another, but we don't limit anyone's scope by defining a space as a specific person's purview. Maintaining a generalist approach gives us the flexibility to nimbly move to the next pockets of earnings strength as the environment evolves.

With earnings driving their work, Friess researchers are sticklers for earnings quality. If two companies are both poised to grow earnings 20 percent in the year ahead, we want to know how they're getting there: Is one rolling out a new product and capturing market share while the other mainly benefits from unrepeatable cost cuts? We want to ensure that the earnings a company reports accurately reflect the company's operational performance.

In addition to being free from sector or industry restrictions, Friess researchers enjoy the ability to search among companies of all sizes. Even though we manage portfolios with specific portfolio guidelines, Friess researchers are not constrained to conducting research in any predefined market-cap window.

We aim to isolate companies poised to deliver rapid year-over-year earnings growth – typically more than 20 percent – that also enjoy good prospects to exceed consensus earnings expectations. Since we also strive to own companies before their success is fully reflected in their stock prices, we focus our efforts on isolating rapidly growing companies that also sell at reasonable multiples of earnings estimates. We generally target companies that sell for less than 30 times year-ahead forecasts.

Exhaustive research is the key to our earnings-driven approach. We develop individualized earnings expectations for every existing holding and target company by keeping in constant contact with executives and others who manage, interact with and/or work in the same industry as these companies.

We use the term "trade check" to describe the interviews we conduct with company management teams, customers, competitors and suppliers. Trade checks include in-person (pandemic permitting) company visits, trade shows, user conferences and discussions via phone.

The Friess research team conducts scores of trade checks as part of an ongoing effort to glean insights on existing and potential holdings. Trade checks represent one of our most fruitful methods of idea generation, with research legwork often uncovering promising opportunities outside of the initial direction of our investigation.

Once we use this system to establish internal earnings estimates, we focus our attention on the companies with rapid growth prospects, sound fundamentals and solid balance sheets, including low debt and high returns on equity. We also demand a timetable of near-term growth catalysts, such as a new product launch, management team or market opportunity, likely to drive earnings upside.

Friess Associates is an active, bottom-up manager. We use our company-level research findings to build portfolios one company at a time without regard to the composition of any particular passive index. Maintaining an individual-company focus typically results in portfolios with low correlations to benchmarks. Our goal is to outperform the indexes, not mimic them.

Friess Investment Strategy Highlights

- Rapidly growing companies
- Reasonable price-to-earnings ratios
- Focus on companies likely to exceed consensus earnings estimates
- Emphasis on under-researched, lesser-known companies rather than industry leaders
- Intensive and repeated contacts with company management teams, customers, competitors and suppliers

On the Cutting Edge

Every so often, we like to highlight examples of innovative ideas that cross your team's radar screen. Chances to capitalize on investment opportunities related to them may lie in the future or may never materialize.

A Maize-ing Alternative to Styrofoam

Expanded polystyrene (EPS) foam, commonly known by the trademarked name Styrofoam, remains widely used in coffee cups, food packaging, packing material and other applications despite its confirmed ecological drawbacks. A toxic pollutant, EPS is not biodegradable. Scientists at University of Gottingen in Germany believe they developed a foam that performs like EPS without the downside. Their secret? Popcorn. Producing the foam begins with shredding corn grain into granules, which are then exposed to pressurized steam to make them pop. The expanded granules are then mixed with a bonding agent derived from a plant protein before being pressed into a mold to cure. The resulting rigid foam absorbs heat better and is more flame retardant than EPS, according to the university. The researchers say their popcorn foam can be shredded for reuse or composted. The university recently licensed the technology to the German building material company Bachl Group, which plans to incorporate it into building insulation. Other potential applications that the researchers envision include protective packaging, acoustic panels and door panels, among other uses.

Gecko-Grip Equipped Robotic Arm

Robotic hands tend to be either dexterous or strong. With the farmHand, a name that pays homage to Stanford University's founding on a donated family farm, researchers believe they came up with a robotic hand that boasts an unmatched mix of power and precision. The farmHand consists of four fingers that take cues from human flanges in the form of multiple joints. The surface of those fingers takes it inspiration from the gecko, more specifically the 60 percent of the species equipped with naturally adhesive toe pads. Gecko toe pads include microscopic bristles that together create a temporary intermolecular bond with the surfaces they touch, called a van der Waals force. The farmHand's finger pads incorporate microscopic flaps that make the same type of adhesive connection. The pads are structured in a way that equally distributes force at points of contact, strengthening grip while reducing the chance of damaging a gripped item. Tests demonstrating the farmHand's range of capabilities included handling eggs, grapes, containers of liquid, basketballs and, in one instance, an angle grinder.

There's Such a Thing as Too Cool

The problem with reflective "cool roof" systems designed to cool buildings by reflecting sunlight and radiating heat away from a roof's surface is that they remain effective even after summer months pass, offsetting warm-weather savings with increased heating costs when temperatures drop. Berkeley Labs materials scientists created what they believe to be groundbreaking technology that outperforms commercial cool-roof systems by saving energy all year long. The new material they developed, called temperature-adaptive radiative coating (TARC), capitalizes on unique properties of vanadium dioxide they identified in 2017. They found that electrons in the compound conduct electricity without conducting much heat. Below 153 degrees Fahrenheit, vanadium dioxide is a transparent to thermal-infrared light and, as a result, does not absorb it. Above that temperature, it switches to a metal state and absorbs the light. TARC uses those characteristics to let sun pass through when it's cold out but reflect the sun and radiate heat when it's hot out. Tests showed the material to be especially effective in regions with big temperature variations between day and night or winter and summer.

Targeted Solution to Herbicide Overuse

To weed something out is to selectively remove, eliminate or otherwise separate it from a collection or group. Yet, when it comes to commercial agriculture, the process used to eliminate weeds is far from selective. The widespread practice of broadcast spraying herbicides is wasteful and harmful to the environment, so a more targeted approach would seem likely to win broad acceptance given the potential benefits in terms of costs and farmland management. At least that's what Greeneye Technology hopes. The Israeli agricultural-technology company purports that its Greeneye selective spraying system only dispenses herbicide where weeds reside. The system consists of a boom sprayer outfitted with a series of downward-facing camera arms that survey the field just in front of the sprayer. Artificial-intelligence-driven technology discerns between crops and weeds, activating targeted spraying only when weeds are identified. The company says the system also offers a range of diagnostic capabilities. Greeneye introduced the system to the Israeli market in October and plans to enter the U.S. market in 2022.

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Earnings growth rates quoted refer solely to the estimated earnings growth rates of the average investment holding of Friess Associates based on consensus estimates. This is not a forecast of future performance. Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio. Diversification does not guarantee a profit or protect against a loss in declining markets.

Earnings per share, or EPS, is the portion of a company's profit allocated to each outstanding share of common stock. The Price-to-Earnings (P/E) Ratio is calculated by dividing current price of the stock by the company's estimated earnings per share for the current calendar year. "Bought" date highlighted in stock charts represents the initial purchase date by Friess Associates. The S&P 500® Index is a capitalization-weighted index. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The index is unmanaged, unavailable for investment and does not incur expenses.

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